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A FOREIGN SCHOLAR PONDERS THE 1957 CENSUS OF GOVERNMENTS

AS IT MIGHT HAVE BEEN TOLD TO L. LASZLO ECKER-RACZ [1]

THE publication of the results of the *1957 Census of Governments,* now in process, is well timed. A number of states and a disconcertingly large number of local jurisdictions are currently grappling with fiscal problems they believe to be formidable, if not overwhelming. The new compilation provides for the first time since the 1942 Census comprehensive fiscal data for the several categories of local government on a state-by-state basis. It will also supply county-by-county figures on local government finances, a type of information that has not been available for twenty-five years—since the 1932 Census.

While the pattern of the 1957 Census is essentially that of its more recent prototypes, the detail is much improved. Moreover, it is supplemented with an updated inventory of governmental jurisdictions and their forms of organization, detailed information on public employment and payrolls by functions, data on retirement systems, and comprehensive statistics on the property tax, including estimates of the relationship between assessed valuations and market values. A special feature of the current compilation is the aggregation of data for some 15,000 local jurisdictions by standard metropolitan areas; the 174 such areas now account for about 3/5ths of the country's total population. These supporting data will permit the fiscal information to be interpreted against a reasonably well-illuminated institutional background.

Public officials, citizens' groups and special pleaders addicted to analogizing are now afforded a stockpile of " comparable " jurisdictions from which to choose those best suited to their argument. Researchers now have their statistical universe, whether it be the 48 states (Alaska and Hawaii will have to await the next census) or some segment of the more than 100,000 cities, towns, counties, school districts, special districts, etc. Aspirants to Ph.D.'s need not want for dissertation topics.

The new Census appears to interest especially students of the subject from foreign lands. The detail of their inquiries has frequently challenged their American hosts. They search these details for clues to the solution of their home problems, much as we do. Specifically what they look for, how they interpret what they find, and what more

[1] The writer is an economist with the United States Treasury but this paper may not reflect the views of the agency with which he is associated.

they wish they could find had best be told by one of them, synthesized for this occasion by their ghost writer:

To the Editor of the National
Tax Journal

Dear Sir:

It will come as no surprise to you that fiscal economists in our part of the world give close study to governmental finances in the United States of America. Your federal system, embracing some 100,000 separate political jurisdic-dictions with a wide variety of social, economic, demographic and political characteristics and operating against a background of a dynamic society, is a fiscal laboratory we have long found instructive. Your census of "Wealth, Debt and Taxation" (meaning state and local finances) conducted once each decade since 1850 is one of our standard reference tools. This explains our disappointment when the congress failed to appropriate the $2 million which would have been required to conduct the decennial census of governments scheduled for 1952. It explains also the timing of my group's visit to your country and the eagerness with which we have pounced on the advance releases of the *1957 Census of Governments.*

During the fifteen years which have elapsed between your two censuses (1942 and 1957), the United States has undergone vast change; and we are trying hard to interpret the implications of that change for state and local finances, since from the viewpoint of size our own national problem is on a scale more like that of one of your states than of the federal government. The results of the new Census, however, raise almost as many questions as they answer, at least for those lacking familiarity with the niceties of your governmental structure. My purpose in writing you is to raise some of these questions, hoping that the researches of some of your readers might provide answers to them. My further purpose is to check with you some tentative conclusions. While our consultations have carried us to many parts of your country and exposed us to diverse viewpoints, we may have been unduly influenced by one of our more articulate American friends.

The Role of State and Local Finances

One of the more complex features of your governmental system is the relative role of state and local jurisdictions in your total governmental structure. The summary fiscal statistics presented in Table I reveal striking shifts over the last half century.[2] Some of these

[2] The time series presented herein (Tables 1, 3, 11 and 17) are derived from the *1957 Census of Governments, Governmental Finances in the United States, 1902 to 1957* (Advance release No. 9). All other tables pertain to 1957 alone and are derived from *State and Local Government Finances in 1957* (Advance release No. 8). The data for 1957 used in the time series differ in some respects (mostly minor) from those in the tables limited to 1957. They reflect revisions made in the preliminary 1957 data during the interval between the two publications. These revisions could not be carried into the tables for 1957 because they are not yet available in the required state-by-state detail.

Following is a list of all the reports of the *1957 Census of Governments* (starred items have been supplemented by or included in later reports):

Preliminary releases (available from the Bureau of the Census, Washington 25, D. C.):

- *No. 1. *School Districts in 1956-57* (2 pp., 10¢)
- *No. 2. *Governments in the United States in 1957* (11 pp., 10¢)
- No. 3. *Real Estate Assessments in the United States* (14 pp., 10¢)
- No. 4. *State and Local Government Indebtedness* (3 pp., 10¢)
- No. 5. *Property Tax Assessments in the United States* (40 pp., 50¢)
- *No. 6. *Public Employment in April 1957*

shifts are presumably explained by the increased emphasis on individual governmental functions, notably national defence, which is exclusively a federal responsibility.

State and local governments now account for more than a third of governmental expenditures in the United States. During World War II they accounted for only a fifth. This growth in the relative role of state and local governments surprised us for we have encountered frequent allegations about a recent trend toward federalization. In the prewar years, of course, the share of your state and local governments was larger. Defense and international activities, exclusively federal government responsibilities, were then relatively much smaller.

Census Aggregates

The principal state and local aggregates from the 1957 Census are summarized in Table II. With respect to the income and outgo items, we are here restricting our queries to " general revenue " and " general expenditures " and their components, because we are unable to interpret the meaning of some of the

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(18 pp., 25¢)

No. 7. *Assessed Values and Sales Prices of Transferred Real Property* (30 pp., 25¢)

No. 8. *State and Local Government Finances in 1957* (76 pp., $1.00)

No. 9. *Governmental Finances in the United States, 1902 to 1957* (25 pp., 25¢)

Final reports (available from the Superintendent of Documents, Washington 25, D. C.):

Vol. I. Governmental Organizations:

No. 1. *Governments in the United States* (56 pp., 40¢)

No. 2. *Local Government in Standard Metropolitan Areas* (52 pp., 40¢)

No. 3. *Local Government Structure* (89 pp., 55¢)

No. 4. *Elective Offices of State and Local Governments* (105 pp., 60¢)

Vol. II. Governmental Employment:

No. 1. *Summary of Public Employment* (132 pp., 75¢)

No. 2. *Compendium of Public Employment* (936 pp., $5.00)

No. 3. *Local Government Employment in Standard Metropolitan Areas* (73 pp., 50¢)

Vol. III. Governmental Finances:

No. 1. *Finances of School Districts* (371 pp., $2.00)

No. 2. *Finances of Special Districts* (39 pp., 30¢)

**No. 3. *Finances of Municipalities and Township Governments*

**No. 4. *Finances of County Governments*

**No. 5. *Compendium of Government Finances*

**No. 6. *Local Government Finances in Standard Metropolitan Areas*

Vol. IV. Topical Studies:

No. 1. *Employee-Retirement Systems of State and Local Governments* (53 pp., 40¢)

**No. 2. *State Payments to Local Governments*

**No. 3. *Historical Summary of Governmental Finances in the United States*

**No. 4. *Graphic Summary of the 1957 Census of Governments*

**Vol. V. Taxable Property Values in the United States.

**Vol. VI. State Bulletins:

No. 1. Alabama	No. 28. New Jersey
No. 2. Arizona	No. 29. New Mexico
No. 3. Arkansas	No. 30. New York
No. 4. California	No. 31. North Carolina
No. 5. Colorado	No. 32. North Dakota
No. 6. Connecticut	No. 33. Ohio
No. 7. Delaware	No. 34. Oklahoma
No. 8. Florida	No. 35. Oregon
No. 9. Georgia	No. 36. Pennsylvania
No. 10. Idaho	No. 37. Rhode Island
No. 11. Illinois	No. 38. South Carolina
No. 12. Indiana	No. 39. South Dakota
No. 13. Iowa	No. 40. Tennessee
No. 14. Kansas	No. 41. Texas
No. 15. Kentucky	No. 42. Utah
No. 16. Louisiana	No. 43. Vermont
No. 17. Maine	No. 44. Virginia
No. 18. Maryland	No. 45. Washington
No. 19. Massachusetts	No. 46. West Virginia
No. 20. Michigan	No. 47. Wisconsin
No. 21. Minnesota	No. 48. Wyoming
No. 22. Mississippi	No. 49. District of Columbia
No. 23. Missouri	Alaska
No. 24. Montana	Hawaii
No. 25. Nebraska	Puerto Rico
No. 26. Nevada	
No. 27. New Hampshire	

** To be published after June 30, 1959.

items falling outside these designations (such as utilities and liquor stores) for governmental finances. The Census reports the operations of the utilities and of the liquor stores on a gross transaction basis, apparently to approximate the concept of "payments to and from the public." In consequence, the reported revenues of these operations include gross business receipts and their expenditures embrace all spending involved in the conduct of these businesses, including purchase of goods and cost of operations. Whether these activities contribute anything to general government financing cannot be ascertained from these operating statistics. The question may be particularly significant in the case of liquor stores, since at least some of the 16 state governments which operate them, we are told, employ the mark-up factor (in pricing merchandise for sale), as an alternative to excise taxes on alcoholic beverages. Some communities find utility operations profitable, and some regularly absorb into utility charges, such as water rates, the cost of such local governmental services as sanitation and trash collection. This suggests that the omission of the contribution of these business-like operations to "general revenues" and "general expenditures" impairs the comparability of these concepts between jurisdictions. You would know whether this is significant.

TABLE I

State and Local Finances as Per Cent of Federal, State and Local Finances, Selected Years 1902–1957

(Amounts in millions of dollars)

	1957	1948	1942	1932	1922	1913	1902
General revenues:							
All governments	$113,735	$ 59,666	$24,347	$ 9,578	$ 8,894	$2,862	$1,632
State and local:[1]							
Amount	38,310	17,250	10,418	7,267	4,781	1,912	986
Per cent of total ..	33.7%	28.9%	42.8%	75.9%	53.8%	66.8%	60.4%
Taxes:							
All governments	$ 98,858	$ 51,218	$20,793	$ 7,977	$ 7,387	$2,271	$1,373
State and local:							
Amount	29,042	13,342	8,528	6,164	4,016	1,609	860
Per cent of total ..	29.4%	26.0%	41.0%	77.3%	54.4%	70.8%	62.6%
General expenditures:							
All governments	$110,676	$ 50,088	$43,483	$11,748	$ 8,854	$3,022	$1,578
State and local:							
Amount	40,438	17,684	9,190	7,765	5,218	2,064	1,013
Per cent of total ..	36.5%	35.3%	21.1%	66.1%	58.9%	68.3%	64.2%
Debt outstanding, end of year							
All governments	$323,260	$270,948	$92,128	$38,692	$33,072	$5,607	$3,285
State and local:							
Amount	52,733	18,656	19,706	19,205	10,109	4,414	2,107
Per cent of total ..	16.3%	6.9%	21.4%	49.6%	30.6%	78.7%	64.1%

[1] Includes Federal aid.

Growth of General Government Expenditures

Recent United States literature lays great stress on the upward trend of state and local expenditures. With ben-

efit of the Bureau of the Census' historical data we have compiled a record of expenditures extending over fifty years (Table III). The rise in the dollar amount of state and local expenditures has indeed been spectacular: 40-fold since the turn of the century and 5-fold during the last 25 years. However, in terms of population, growing urbanization, price changes and the growth of the economy, the increase is not really remarkable. Indeed, it would not have been surprising to have found it larger, considering the conspicuous increase in the United States' standard of living and in private expenditures for such consumer amenities as radio, television, automobiles, air conditioners, golf, and speed boats. These were truly spectacular!

TABLE II

SUMMARY OF STATE AND LOCAL GOVERNMENT FINANCES, 1957
(Amounts in millions)

	Amount	Per capita
Intergovernmental revenue ..	$ 3,843	$ 22.57
General revenue from own sources	34,319	201.53
Total general revenue ..	38,162	224.10
Utility, liquor and insurance trust revenue	7,759	45.57
Total revenue	45,922	269.66
Direct general expenditure ..	40,420	237.35
Utility, liquor and insurance trust expenditure	7,206	42.32
Total expenditure	47,626	279.67
Long-term debt issued during year	6,806	39.97
Long-term debt retired during year	2,749	16.15
Total debt outstanding end of year	53,223	312.54
Net long-term debt outstanding end of year	46,737	274.45
Cash and security holdings ..	48,756	286.31

Interpretation of the historical data summarized in Table III is beset with some difficulty because so many of your census years are atypical of what preceded or followed. The consistency with which recent census dates fell on unrepresentative years is quite noteworthy. The 1922 Census was distorted by 1920-21 depression, the 1932 Census by the Country's "great depression" and the 1942 Census by World War II. (We think it ironical that if the Congress had done what it had been urged to do, and had matched its census authorization with an appropriation to make it possible, the 1952 census would also have coincided with an abnormal year.) A comparison of 1957 with ten years earlier, 1948, is reasonably free of these kinds of abnormalities. By 1948 state and local governments had returned to a measure of normalcy after the war when public expenditures for civilian programs were unnaturally small, partly as a result of deliberate economic policy and partly of necessity prescribed by material and personnel shortages.

During this postwar decade, the amount of state and local expenditures in current dollars increased nearly 130 per cent; per capita expenditures nearly 100 per cent. In terms of constant prices, however, per capita costs increased about 39 per cent. Does this mean that the quantity and quality of governmental services supplied to the average American improved about a third? What has happened to the productivity of the tax dollar? Does it buy more or less than ten years ago after adjustment for price changes? The increases in the ratio of state and local expenditures to gross national product and to national income were also of this general magnitude, 35 per cent for the former and 40 per cent

for the latter. This is a sizable increase in the proportion of national resources devoted to public as compared with private goods. Have you any data on the productivity of public expenditures as compared with private expenditures? [3] We wish also that more were known about the relationship between public and private consumption during different phases of economic growth. These questions are all the more germane because after a decade of a persistent increase, the ratio of state and local expenditures to gross national product and national income had by 1957 reached only the approximate level which prevailed on the eve of World War II. On the other hand, you are now devoting a much larger share of your resources to state and local government than in the 1920's. Query: What is the more appropriate norm, the 1920's or the late 1930's? Indeed, would a norm have any meaning at all?

TABLE III

STATE AND LOCAL GENERAL EXPENDITURES, SELECTED YEARS 1902–1957

Fiscal year	Total general expenditures: Amount (millions)	Total general expenditures: As per cent of GNP	Total general expenditures: As per cent of national income	Per capita expenditures: Current prices	Per capita expenditures: 1954 prices [1]
1957	$40,438	9.18%	11.11%	$237.46	$211.26
1956	36,711	8.76	10.51	219.48	204.74
1955	33,724	8.48	10.21	204.27	199.87
1954	30,701	8.46	10.17	189.03	189.03
1953	27,910	7.64	9.13	174.84	179.32
1952	26,098	7.52	8.93	166.20	175.32
1950	22,787	8.01	9.42	150.23	179.49
1948	17,684	6.82	7.91	120.60	152.08
1946	11,028	5.23	6.10	78.00	123.81
1944	8,863	4.19	4.85	64.04	117.29
1942	9,190	5.78	6.67	68.14	136.83
1940	9,229	9.17	11.31	69.85	159.11
1938	8,757	10.28	12.95	67.45	155.41
1936	7,644	9.24	11.78	59.69	141.45
1934	7,181	11.05	14.66	56.82	132.76
1932	7,765	13.27	18.27	62.20	156.68
1927	7,210	7.5	....	60.57	.....
1922	5,218	7.0	....	47.41	.....
1913	2,064	5.2	....	21.23	.....
1902	1,013	....	....	12.80	.....
Percentage increase 1948 to 1957	128.7%	34.6%	40.5%	96.9%	38.9%

[1] For price deflator for state and local purchases of goods and services, see *U. S. Income and Output, A Supplement to the Survey of Current Business*, 1959.

General Government Expenditures in 1957

The principal expenditure categories of state and local governments in 1957 are shown in Table IV. The costliest function by far is education. It accounts for over a third (35 per cent) of the total, averages $83 per capita, and corresponds to 3.2 per cent of gross

[3] It might be instructive to re-examine Solomon Fabricant's analysis in Chap. 5 of *The Trend of Government Activity in the U. S. Since 1900* (New York: National Bureau of Economic Research, 1952) in light of the *1957 Census* data.

national product. Highways, the second most costly function, account for nearly 20 per cent of the total, and public welfare and health and hospitals for about 8 per cent each. These four categories absorb 70 per cent of state and local general government costs.

A striking feature of United States governmental finances is the variation between states. In 1957, when per capita general government expenditures averaged $237, the individual state per capitas ranged from $148 for Arkansas to $368 for Nevada, both relatively unindustrialized, rural states. We have been to Nevada and would not have surmised that it led the other 47 states in governmental programs. What explains this? Surely it isn't anything associated with its unusual economy. We suspect that sparseness of population is a factor since this was your most thinly populated state, by far (before you added Alaska).

The relationship between per capita incomes and per capita governmental expenditures depicted in Table V suggests that there is a high association between income levels and the level of expenditures.[4] Seven of the eight lowest income states are in the lowest per capita expenditure column; five of the eight highest income states in the largest expenditure column. This relationship persists in a general way throughout the income scale. Unhappily, we travel light and lack facilities for the precise measurement of the degree of correlation and are therefore obliged to rely on visual observation.

In Table VI, per capita expenditures are related to tax effort, as measured by the amount of state and local tax revenues per $1,000 of personal income. Some concentration is again evident at the extremes but the pattern is less marked. How is this to be interpreted? If we may anticipate some of the tax data introduced later in this inquiry (Table XIII), the statistics appear to suggest that this is a question of tastes. Some states overcome their relatively

TABLE IV

STATE AND LOCAL DIRECT GENERAL EXPENDITURES, BY CATEGORIES, 1957

Expenditure category	Amount (millions)	Per capita	Per cent of total	Per cent of GNP
Education	$14,134	$ 83.00	35.0%	3.2%
Higher education (State)	$ 1,958	$ 11.50	4.9%	0.4%
Local schools	11,852	69.60	29.3	2.7
Other	324	1.90	0.8	0.1
Highways	7,798	45.79	19.3	1.8
Public welfare	3,396	19.94	8.4	0.8
Health and hospitals	3,202	18.80	7.9	0.7
Police and fire protection	2,302	13.52	5.7	0.5
General control	1,722	10.11	4.3	0.4
Sanitation	1,484	8.72	3.7	0.3
Interest on general debt	1,106	6.49	2.7	0.3
Natural resources	1,030	6.05	2.5	0.2
All other	4,244	24.92	10.5	1.0
Total	$40,420	$237.35	100.0%	9.2%

[4] The Census Bureau includes the District of Columbia with its state statistics but we have excluded it from all our frequency tables in the interest of comparability.

lower incomes by greater tax effort, while some high-income states choose to devote relatively small amounts to governmental services. The state in the lowest tax-effort tier reporting the highest per capita expenditure in Connecticut. The converse case is Mississippi, which reports the second highest tax effort with the second lowest per capita expenditure. Is this principally a reflection of differing attitudes toward governmental services or do needs vary widely between states? (The Nevada situation comes to mind again.) This is an aspect of the problem on which public-finance theory, to which the Anglo-Saxon world has contributed so abundantly, appears to shed very little light. A theory of public expenditures would be even more helpful in explaining the allocation of state and local fiscal resources among the different categories of expenditures. Let me illustrate.

TABLE V

STATE AND LOCAL GENERAL EXPENDITURES AND PERSONAL INCOMES, 1957 [1]

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita general expenditure						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	7	1	..	..	..	..	8
B	1	1	2	2	2	..	8
C	..	2	2	1	3	..	8
D	..	2	1	3	1	1	8
E	..	2	1	1	2	2	8
F	..	..	2	1	..	5	8
All states	8	8	8	8	8	8	48

[1] This and subsequent frequency tables are derived from Table XXII.

Table VII makes clear that the correspondence between per capita incomes and per capita expenditures for local schools is very marked. Of the 16 lowest income states, 14 fall into the three lowest per capita expenditure columns. Conversely, 13 of the 16 highest income states fall into the three highest expenditure columns. These public school costs represent by far the largest single expenditure category in state-local budgets, accounting for nearly 30 per cent of the total. However, the wide variation between states leads us to wonder about the correspondence between expenditures for local schools and the adequacy of education programs. Can it be that economic capacity limits the availability of resources for public education even in this wealthy nation? Questions about the relationship between the amount of expenditures and the quality of programs keep recurring as we examine function after function.

TABLE VI

STATE AND LOCAL GENERAL EXPENDITURES AND STATE AND LOCAL TAX REVENUES PER $1,000 OF PERSONAL INCOME, 1957

6 groups of 8 states arrayed in rank order of tax revenue per $1,000 of personal income	6 groups of 8 states arrayed in rank order of per capita general expenditure						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	1	2	2	2	..	1	8
B	2	5	1	..	..	..	8
C	3	1	..	1	1	2	8
D	1	..	2	..	2	3	8
E	..	..	2	3	2	1	8
F	1	..	1	2	3	1	8
All states	8	8	8	8	8	8	48

The correlation between economic capacity as measured by per capita personal income and per capita governmental expenditure is even more striking in the case of health and hospital expenditures (Table VIII). Eleven of the 16

lowest income states fall into the two lowest expenditure columns; 11 of the 16 highest income states, into the two highest expenditure columns.

It is noteworthy that both of these activities, public education and health and hospitals, are financed almost exclusively from state and local revenue sources. Federal funds provide less than 5 per cent of the cost of these two programs. This contrasts with the welfare function in which the federal revenue contribution is nearly half and to a lesser degree with highways, where the federal government financed over 10 per cent of expenditure in 1957 and an even larger share since.

TABLE VII

STATE AND LOCAL EXPENDITURES FOR LOCAL SCHOOLS AND PERSONAL INCOMES, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita expenditure for local schools						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	5	3	..	..	..	..	8
B	2	1	3	2	..	..	8
C	..	1	1	2	2	2	8
D	1	3	1	..	2	1	8
E	..	..	2	2	2	2	8
F	..	..	1	2	2	3	8
All states	8	8	8	8	8	8	48

TABLE VIII

STATE AND LOCAL EXPENDITURES FOR HEALTH AND HOSPITALS AND PERSONAL INCOMES, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita expenditure for health and hospitals						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	4	1	2	..	1	..	8
B	3	3	..	2	..	..	8
C	1	3	2	2	..	..	8
D	..	1	2	1	2	2	8
E	..	..	2	2	2	2	8
F	..	..	..	1	3	4	8
All states	8	8	8	8	8	8	48

Tables IX and X summarize the relationship between per capita expenditures for these two functions and the level of personal incomes. In the case of highways, no clearly defined pattern is discernible except in the case of the eight lowest income states, which uniformly reported the lowest per capita expenditures for all 48 states. Is this possibly explained by the inability of these states to raise the funds required to match federal grants? Another possibility is variation in need. Could the states with the lowest incomes by coincidence happen to be the states which contain relatively few miles of the costly interstate thruways?

Table X, relating to public-welfare expenditures, is even more difficult to interpret. Per capita expenditures for this function range from $7 in Virginia to $46 in Oklahoma. Virginia ranks 34th and Oklahoma 37th in per capita income. Delaware, with the second highest per capita income, ranks 43rd in per capita welfare expenditure, while Alabama, 44th in income rank, is 8th in welfare expenditure. A number of other high-income states also report very low per capita expenditures. Have they relatively fewer welfare cases or has their prosperity made them oblivious to the problems of the needy? Most of these are heavily industrialized, as for example, Delaware, New Jersey, and Illinois, suggesting as a possible explanation that the welfare load in these states is rela-

tively light, or that a relatively large share of the burden of the aged in these states is carried by the old-age and survivors' insurance program, financed outside state and local budgets or by private charity. The column representing the highest per capita expenditures includes some low income states, notably Alabama, Louisiana, and Oklahoma. In each of these, the proportion of expenditures accounted for by public welfare is conspicuously larger than the national average. It has been suggested to us that this might be related to the political strength of the aged population.

These expenditure data point up a government-financing problem which gives us considerable pause: What criteria can we employ to guide us in the allocation of revenue resources among competing needs? This is closely related to the development of standards for appraising program results and efficiency of performance in terms of costs. How will we know when the resources devoted to a particular function are utilized efficiently? In the absence of objective standards for evaluating performance and competing claims on the taxpayer's dollar, how can optimum allocation of the limited resources among programs and the optimum allocation of total resources between private and public uses be assured? Without such standards, budgeting efforts are vulnerable to competing political pressures. This is perhaps secondary for your scale of values, but not for our less developed economies which can ill-afford misallocation of resources.

TABLE IX

State and Local Expenditures for Highways and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita expenditure for highways						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	6	2	..	..	..	..	8
B	1	..	2	1	2	2	8
C	..	1	1	2	2	2	8
D	..	2	1	2	2	1	8
E	1	1	2	2	1	1	8
F	..	2	2	1	1	2	8
All states	8	8	8	8	8	8	48

TABLE X

State and Local Expenditures for Public Welfare and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita expenditure for public welfare						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	2	1	2	1	1	1	8
B	1	2	2	1	..	2	8
C	1	..	1	3	3	..	8
D	..	1	1	2	3	1	8
E	2	2	1	1	..	2	8
F	2	2	1	..	1	2	8
All states	8	8	8	8	8	8	48

The Census results thus far published report state totals. Subsequent individual state volumes, we understand, will report corresponding data for individual local jurisdictions. It will then be possible to relate the cost of particular governmental functions to the appropriate characteristics of the population, to the size and type of the governmental units, to the composition of the economy, etc. The isolation of jurisdictions by size and other essential characteristics should cast some light on such issues as economy of size. One of the group of variables involved is the method of financing—the kinds of taxes, nontax revenues, and

borrowing—and in this regard, too, the 1957 Census is a source for comparable basic data, to which I would now like to direct your attention.

General Government Revenues in 1957

The composition of the aggregate revenue structures of state and local governments in 1957 and ten and fifteen years earlier is summarized in Table XI. We are struck both by the change and by the lack of change. The magnitudes have more than doubled since 1948 and nearly quadrupled since 1942, but the relative weight of the major components has been remarkably stable. The oft-discussed revolution in state and local tax systems and in federal aid is not apparent in these aggregates. Federal aid provided about a tenth of general revenues in both 1948 and 1957; the property tax about a third; sales and gross-receipts taxes about a fourth; and the taxes on individual and corporation incomes about 7 per cent. It would be interesting to examine the composition of state-local tax systems, state by state, but this has to await the publication of the individual state volumes. The summary volume details only the property tax and lumps all non-property taxes into a single item.

In terms of constant prices, per capita general revenues are about 70 per cent higher than ten years ago. The increase in relation to gross national product and national income was on a smaller scale, about a third. How do you square this with the prevailing view that the states have no belt room in their taxing powers? The national aggregates and more particularly the data from some of the individual states reveal far more latitude for tax expansion than we have been led to expect was possible under the division of taxing powers among your governmental levels.

TABLE XI

SOURCES OF STATE AND LOCAL GENERAL REVENUE 1942, 1948 AND 1957

(Amounts in millions)

	1957		1948		1942	
	Amount	Per cent of total	Amount	Per cent of total	Amount	Per cent of total
Federal aid	$ 3,838	10.0%	$ 1,861	10.8%	$ 858	8.2%
Taxes	29,042	75.8	13,342	77.3	8,528	81.9
Individual income	1,767	4.6	543	3.1	276	2.6
Corporation income	984	2.6	592	3.4	272	2.6
Sales and gross receipts	9,461	24.7	4,442	25.8	2,351	22.6
Property	13,097	34.2	6,126	35.5	4,537	43.6
Other taxes	3,733	9.7	1,638	9.5	1,092	10.5
Miscellaneous general revenue	5,430	14.2	2,047	11.9	1,031	9.9
Total general revenue:						
Amount in current prices	$ 38,310	100.0%	$ 17,250	100.0%	$ 10,418	100.0%
Per cent of GNP	8.7%		6.6%		6.5%	
Per cent of national income	10.5%		7.7%		7.6%	
Per capita, in current prices	$224.97		$117.64		$ 77.25	
Per capita, in constant prices[1]	$191.30		$112.68		$120.33	

[1] Deflated by BLS wholesale price index.

In 1957, the per capita amount of taxes collected by state and local governments ranged from $100 in Arkansas to $238 in California. This wide variation presumably reflects taxpaying capacity and taxpaying effort. Table XII summarizes the distribution of the 48 states in six groups of eight states each, arrayed on the basis of per capita incomes and per capita tax collections. In general, tax collections tend to be smallest in the low-income states and highest in the high-income states. The concentration is most marked at the extremes, and there are important exceptions to the generalization. The most conspicuous is Delaware, which ranks second in personal income and 38th in per capita tax collections. A corresponding tabulation of property-tax collections and personal incomes shows a very similar distribution. This is not unexpected, in view of the prominent role this tax plays in state-local revenue systems.

TABLE XII
State and Local Tax Revenues and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita tax revenue						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	7	1	..	..	..	..	8
B	1	1	3	3	..	..	8
C	..	2	1	3	2	..	8
D	..	2	2	..	3	1	8
E	..	1	2	1	2	2	8
F	..	1	..	1	1	5	8
All states	8	8	8	8	8	8	48

To obtain a measure of interstate variations in tax effort, we compared per capita incomes with the amount of state and local tax collections per $1,000 of personal income (Table XIII). As expected, the proportion of personal income taken by state and local taxes tends to decrease as per capita personal income increases. None of the eight highest income states ranks highest in tax effort. Indeed, three of the eight (Delaware, Connecticut, and New Jersey) fall in the lowest tax-effort tier. This is true also of the second highest income group. While none of the eight lowest income states is in the lowest tax-effort column, seven fall into the two next lowest columns. A conspicuous case is Mississippi, which ranks lowest in per capita income among the 48 states and makes the second largest tax effort (outranked only by North Dakota), as measured by the amount of tax revenues per $1,000 of personal income.

TABLE XIII
State and Local Tax Revenues per $1,000 of Personal Income and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of amount of state and local tax revenue per $1,000 of personal income						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	..	2	5	..	..	1	8
B	1	1	..	1	2	3	8
C	..	2	..	2	2	2	8
D	1	1	1	1	2	2	8
E	3	1	2	..	2	..	8
F	3	1	..	4	..	..	8
All states	8	8	8	8	8	8	48

Federal Aid

One of the interesting features of the American fiscal system is the role of federal financial assistance in state and local revenue, especially in light of the traditional division of responsibility be-

tween these governments. Responsibility for most civilian functions of government rests with the state and this involves varying burdens, for, as already indicated, fiscal capacity varies widely. In 1957 per capita personal incomes ranged from $958 to $2,821. We have also noted interstate differences in attitudes toward the importance of governmental services and in the relative emphasis placed on different categories of service. We have wondered how you manage to reconcile the resulting interstate and intrastate variations in the quantity and quality of services with the compelling national interest in such basic services as health, education, transportation and welfare. Little wonder you are so preoccupied with the delicacy of intergovernmental relations!

TABLE XIV

Per Cent of State and Local General Revenue Provided by Federal Aid and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per cent of general revenue provided by federal aid						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	..	..	..	3	3	2	8
B	..	1	2	1	3	1	8
C	..	1	2	3	1	1	8
D	1	2	2	1	..	2	8
E	2	3	1	..	1	1	8
F	5	1	1	..	..	1	8
All states	8	8	8	8	8	8	48

Your literature has forewarned us that the role of federal aid in the financing of state and local governments is the product of historical development and political realities and that we should not expect to understand it. The 1957 data, however, reveal a remarkably rational pattern—the lower the state's own resources, the higher generally federal aid, and vice versa. Federal aid tends to equalize state and local fiscal capacity as if by design.

Table XIV summarizes the relation between the percentage contribution of federal aid to state and local general revenues and per capita personal incomes. The inverse relationship between the two variables is noteworthy. Most of the states which derive small proportions of their general revenue from the federal government have high per capita personal incomes and vice versa. The principal exceptions (among the higher income groups) are the mountain states, with small populations, which share with the federal government the revenue proceeds of the lease of mineral rights on public lands under laws enacted years ago and designed for different price conditions. These revenue sharing arrangements are in a

TABLE XV

Per Cent of State and Local Revenue Provided by Federal Aid and Amount of State and Local Tax Revenues per $1,000 of Personal Income, 1957

6 groups of 8 states arrayed in rank order of state and local tax revenue per $1,000 of personal income	6 groups of 8 states arrayed in rank order of per cent of state and local general revenue provided by federal aid						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	3	3	..	1	1	..	8
B	2	1	2	1	1	1	8
C	..	2	1	3	1	1	8
D	2	1	2	1	..	2	8
E	1	..	2	..	3	2	8
F	..	1	1	2	2	2	8
All states	8	8	8	8	8	8	48

special class, and perhaps should not be lumped with federal grants reserved for specific programs which the Congress presumably reviews annually when it votes appropriations.

Table XV suggests that the federal government's percentage contribution to state and and local revenues is not very closely correlated with efforts these governments make to tax themselves, if the amount of tax collections per $1,000 of personal income reflects that effort. At the two extremes, however, the distribution accords with expectations. Some of the states with relatively low tax effort are typically those which receive the smallest share of their revenue in federal aid. Conversely, a significant number of states with relatively very high tax efforts fall into the columns of the states in which federal aid accounts for a large share of general revenues. This latter group generally includes the very low-income states. In a few cases, however, high tax effort corresponds with relatively low federal aid. While the relationship is not consistent throughout the range, these data generally corroborate the interpretation suggested by Table XIV.

TABLE XVI
Amount of Federal Aid and Personal Incomes, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita amount of federal aid						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	..	1	2	4	1	..	8
B	..	2	1	..	3	2	8
C	..	..	2	3	2	1	8
D	1	1	3	..	1	2	8
E	3	2	..	1	..	2	8
F	4	2	..	..	1	1	8
All states	8	8	8	8	8	8	48

A classification of the per capita amount of federal aid with per capita income levels is least revealing (Table XIV). Although the high per capita income states are generally concentrated in the columns with the smallest grants, no pattern is discernible. The low-income states clearly do not receive the largest per capita grants. Is this perhaps due in part, as we have suggested above, to the fact that federal grants tend to be distributed on a matching basis and that low-income states are typically incapable of providing the matching funds required for obtaining the maximum amount of grants?

TABLE XVII
State Taxes as Per Cent of State and Local Taxes, Selected Years 1902–1957
(Amount in millions)

Year	State and local amount	State: Amount	State: Per cent of total
1957	$29,042	$14,531	50.0%
1956	26,368	13,375	50.7
1955	23,483	11,597	49.4
1954	22,067	11,089	50.3
1953	20,908	10,552	50.5
1952	19,323	9,857	51.0
1950	15,914	7,930	49.8
1948	13,342	6,743	50.5
1946	10,094	4,937	48.9
1944	8,774	4,071	46.4
1942	8,528	3,903	45.8
1940	7,810	3,313	42.4
1938	7,605	3;132	41.2
1936	6,701	2,618	39.1
1934	5,912	1,979	33.5
1932	6,164	1,890	30.7
1922	4,016	947	23.6
1913	1,609	301	18.7
1902	860	156	18.1

Another interesting aspect of your intergovernmental relationship is the division of taxing power between the states and their political subdivisions. Table XVII summarizes a half-century re-

TABLE XVIII

STATE TAXES AS PER CENT OF STATE AND LOCAL TAXES, 1957 AND 1953

FREQUENCY DISTRIBUTION

Under 40%		40–50%		50–60%		60–70%		Over 70%	
1957									
New Jersey	28.7%	California	49.6%	Arizona	58.5%	Georgia	67.3%	Alabama	72.0%
Illinois	39.7	Colorado	48.8	Florida	56.0	Kentucky	61.6	Arkansas	70.1
Nebraska	36.4	Connecticut	49.0	Idaho	50.7	Mississippi	68.3	Delaware	76.1
New Hampshire	38.1	Indiana	46.7	Iowa	50.5	Oklahoma	67.9	Louisiana	74.6
New York	38.9	Kansas	42.7	Maryland	54.8	Tennessee	66.1	New Mexico	75.8
South Dakota	37.3	Maine	48.6	Michigan	55.3	Virginia	62.7	North Carolina	73.5
		Massachusetts	40.8	Nevada	58.7	Washington	69.2	South Carolina	74.9
		Minnesota	49.1	Oregon	55.5			West Virginia	70.5
		Missouri	48.1	Pennsylvania	55.6				
		Montana	41.8	Texas	52.4				
		North Dakota	48.1	Utah	56.2				
		Ohio	48.1	Vermont	53.2				
		Rhode Island	48.1	Wisconsin	50.1				
				Wyoming	55.1				
6		13		14		7		8	
1953									
New Jersey	25.9%	Connecticut	46.2%	California	52.5%	Alabama	69.2%	Arkansas	71.8%
Nebraska	36.8	Idaho	47.9	Colorado	50.3	Arizona	61.8	Delaware	72.0
New Hampshire	38.6	Illinois	42.2	Florida	57.2	Georgia	64.6	Louisiana	75.9
New York	39.2	Iowa	43.8	Indiana	52.4	Mississippi	64.0	New Mexico	78.9
South Dakota	39.4	Kansas	47.5	Kentucky	59.5	Oklahoma	69.5	North Carolina	72.3
		Maine	48.8	Maryland	53.7	Tennessee	64.6	South Carolina	73.9
		Massachusetts	40.4	Michigan	58.1	Washington	68.7	West Virginia	71.5
		Minnesota	49.3	North Dakota	51.7				
		Missouri	49.4	Ohio	50.4				
		Montana	45.4	Oregon	53.9				
		Nevada	47.6	Rhode Island	53.0				
		Pennsylvania	49.4	Texas	52.1				
		Wisconsin	46.0	Utah	52.6				
				Vermont	53.9				
				Virginia	59.8				
				Wyoming	57.6				
5		13		16		7		7	

cord of this relationship. The increase in the proportion of total state and local taxes collected by state governments is very striking, from less than a fifth at the beginning, to a half in recent years. Query: Has this come about by design, or is it rather the automatic result of the need to employ nonproperty taxes, which cannot be administered efficiently by local jurisdictions? Local governments appear to be growing increasingly more dependent for revenue on their respective state governments, and the publicized tendency among the states to grant their subdivisions more taxing autonomy does not appear to have interrupted the trend appreciably.

The above generalization, like every generalization about your states, is subject to qualification. The states appear to vary widely in arrangements by which they share taxing powers and revenue collections with their local governments. Some states collect three-fourths of total state and local revenues, giving cities and counties little taxing power beyond the right to tax property, frequently with rigid limitation on tax rates. Others grant broad taxing authority to local governments, collecting a minimum of their revenue for them.

Table XVIII summarizes these facts on a state-by-state basis for 1957 and for 1953, an earlier year for which data have been published. The distribution of states during the two years is similar. The share of taxes collected by the state itself declined moderately during this period in Illinois, California, New Mexico, and Ohio. The first three of these now permit their subdivisions to add a local supplement to the state sales tax, while in Ohio restricted local-income taxes have been sanctioned. In view of the wide taxing powers granted local governments in Pennsylvania, is not the continued increase of the share of state taxes in total state and local taxes in that state unexpected? Since local tax autonomy appears to be particularly low among the southern states and high among the northern states (with conspicuous exceptions, as always), we wonder to what extent this variable is a function of history, the level of governmental service provided, and state assumption of responsibility for functions (roads and to a lesser degree schools) left by other states to their political subdivisions?

TABLE XIX

Net Long Term State and Local Debt as Percentage of Personal Income, 1957

Under 10%			
South Dakota	4.27%	Vermont	8.72%
Iowa	6.23	Idaho	8.73
North Dakota	7.06	Wyoming	9.32
Wisconsin	7.75	Kentucky	9.68
Missouri	8.00	Nevada	9.86
Indiana	8.36	11	
10–15%			
Minnesota	10.02%	Alabama	12.67%
Michigan	10.16	Arkansas	13.05
New Hampshire	10.37	New Mexico	13.21
Montana	10.53	Rhode Island	13.32
California	10.86	Mississippi	13.55
Oregon	10.94	Colorado	13.68
Utah	10.95	Pennsylvania	14.09
Illinois	11.40	South Carolina	14.20
Ohio	11.80	Oklahoma	14.29
North Carolina	12.03	Connecticut	14.33
Virginia	12.07	Georgia	14.50
Maine	12.11	Arizona	14.82
West Virginia	12.29	New Jersey	14.99
		26	
15–20%			
Florida	15.32%	Delaware	18.01%
Texas	16.74	Nebraska	18.34
Kansas	16.87	Tennessee	18.58
Massachusetts	17.25	New York	18.64
	8		
Over 20%			
Louisiana	20.52%	Washington	21.92%
Maryland	20.70	3	

Indebtedness

A conspicuous and well-publicized feature of state and local fiscal developments since World War II has been the increase in indebtedness—from $18.7 billion at the close of 1948 to $52.7 billion at the end of 1957. In the process, the proportion of the outstanding public debt represented by state and local obligations has increased from 6.9 per cent to 16.3 per cent. The percentage, however, was substantially larger before World War II, when the federal debt was relatively much smaller (Table I).

TABLE XX

STATE AND LOCAL NET LONG TERM DEBT AND PERSONAL INCOMES, 1957

6 groups of 8 states arrayed in rank order of per capita personal income	6 groups of 8 states arrayed in rank order of per capita net long term debt						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	2	4	1	1	..	..	8
B	3	..	3	1	1	..	8
C	2	1	..	2	2	1	8
D	1	2	3	1	1	..	8
E	..	1	1	2	2	2	8
F	..	..	..	1	2	5	8
All states	8	8	8	8	8	8	48

The relative weight of the state and local debt measured in terms of the personal income of the population is quite uneven among the several states (Table XIX). It ranges from less than 5 per cent of aggregate annual personal income in South Dakota to over 20 per cent in Louisiana, Maryland, and Washington. About half of the states fall into the 10 to 15 per cent group. As Table XX indicates, low-income states tend to have relatively low indebtedness and vice versa. These data in combination with those on interest payments presented in Table XXI suggest that for low-income states, inability to assume more debt service may be the limiting factor on borrowing. While these states generally report relatively low debt, their interest payments represent a relatively large share of their personal incomes.

TABLE XXI

INTEREST ON GENERAL DEBT AND STATE AND LOCAL TAX REVENUES, 1957

6 groups of 8 states arrayed in rank order of state and local taxes per $1,000 of personal income	6 groups of 8 states arrayed in rank order of amount of interest on general debt per $1,000 of personal income						
From lowest (A) to highest (F)	A	B	C	D	E	F	All states
	Number of states						
A	..	2	1	1	2	2	8
B	1	..	1	3	1	2	8
C	..	1	2	3	2	..	8
D	..	3	1	..	2	2	8
E	4	..	2	1	1	..	8
F	3	2	1	..	..	2	8
All states	8	8	8	8	8	8	48

* * * * *

At this point the amanuensis pleaded fatigue, complaining with some feeling that these visiting scholars are truly incorrigible; their curiosity insatiable. Nonetheless, the flood of questions continued unabated under the stimulus of the new *Census of Governments.* What share of capital improvements is financed out of current income? How wide are the differentials in the cost of borrowing between jurisdictions, and why? Why do you exclude debt retirement from general expenditures? What is the value of government owned assets? How is the investment of trust-fund and general-fund balances handled? What is the retirement coverage of state and local employees and how is it integrated with the social-security system? And so forth, ad infinitum.

TABLE XXII

State and Local Government Finances by States: Selected Items, 1957
(Rank order indicated is from lowest (1) to highest (48))

States	Per capita general expenditures									
	Total		Local schools		Health and hospitals		Highways		Public welfare	
	Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank
Alabama	$178.06	8	$45.07	4	$11.01	6	$43.48	16	$23.04	41
Arizona	272.98	37	88.42	46	12.00	9	50.33	25	17.81	26
Arkansas	147.56	1	39.78	1	10.34	4	34.19	7	19.17	31
California	321.20	45	98.22	48	24.02	43	46.48	20	29.19	42
Colorado	281.07	40	75.88	36	16.95	28	53.82	29	44.51	46
Connecticut	324.63	46	82.21	43	22.99	40	106.69	48	17.51	22
Delaware	243.42	28	75.74	35	17.35	31	52.52	27	12.94	7
Florida	235.95	22	58.56	14	19.44	37	48.73	23	16.69	17
Georgia	185.86	9	58.15	13	19.27	35	31.44	3	20.62	33
Idaho	233.27	21	65.93	23	16.03	25	59.88	36	17.17	20
Illinois	227.73	19	67.51	28	17.75	33	43.88	18	16.32	16
Indiana	206.75	15	66.12	24	16.37	27	37.26	10	11.91	4
Iowa	236.05	23	71.60	31	14.09	16	65.41	38	21.09	36
Kansas	272.79	36	72.94	33	17.21	30	82.40	45	22.32	40
Kentucky	154.18	3	42.09	3	9.93	3	34.12	6	16.97	18
Louisiana	276.55	38	67.15	27	16.26	26	50.00	24	45.82	47
Maine	209.66	17	52.76	8	13.33	13	57.85	34	19.10	30
Maryland	240.35	25	67.11	26	20.12	38	55.40	32	9.52	2
Massachusetts	292.39	43	65.37	22	30.57	46	61.46	37	31.13	45
Michigan	262.81	34	79.45	38	24.12	44	47.34	21	16.30	15
Minnesota	256.70	32	80.63	40	23.45	42	53.45	28	21.34	37
Mississippi	151.84	2	40.07	2	10.61	5	38.85	13	17.69	23
Missouri	196.78	12	58.58	15	14.26	19	38.23	11	30.00	43
Montana	281.73	41	79.01	37	13.07	12	79.02	44	20.81	34
Nebraska	202.39	13	60.79	16	14.13	17	51.20	26	13.50	8
Nevada	367.71	48	74.97	34	31.07	47	89.14	46	15.26	11
New Hampshire	242.87	27	56.45	11	23.42	41	73.57	40	16.28	13
New Jersey	236.81	24	71.68	32	18.91	34	38.71	12	10.15	3
New Mexico	278.37	39	82.15	42	17.18	29	66.65	39	20.25	32
New York	296.05	44	83.90	44	32.30	48	38.97	14	22.04	39
North Carolina	161.79	6	54.27	9	12.73	11	33.85	5	12.00	5
North Dakota	258.67	33	61.44	17	13.58	14	73.77	41	16.27	12
Ohio	222.91	18	71.13	30	14.92	22	45.76	19	17.71	25
Oklahoma	248.57	30	67.08	25	11.69	8	54.00	30	46.37	48
Oregon	271.69	35	83.91	45	15.94	24	58.00	35	18.76	29
Pennsylvania	196.48	11	62.79	18	14.89	21	32.55	4	14.22	9
Rhode Island	209.16	16	49.75	6	17.65	32	36.42	9	21.74	38
South Carolina	154.82	5	57.22	12	14.16	18	25.33	1	12.61	6
South Dakota	244.69	29	65.33	21	8.06	1	78.84	43	16.30	14
Tennessee	163.70	7	48.98	5	14.60	20	35.29	8	14.72	10
Texas	203.81	14	69.11	29	11.36	7	43.86	17	17.05	19
Utah	232.40	20	79.94	39	12.62	10	41.17	15	18.45	27
Vermont	249.22	31	64.21	19	15.39	23	74.66	42	21.04	35
Virginia	187.22	10	55.39	10	13.82	15	47.73	22	6.77	1
Washington	286.20	42	81.97	41	22.57	39	57.25	33	30.36	44
West Virginia	154.81	4	51.24	7	9.18	2	30.11	2	17.71	24
Wisconsin	242.83	26	64.27	20	19.39	36	54.07	31	18.49	28
Wyoming	328.49	47	94.41	47	24.98	45	92.80	47	17.33	21
48 States Median	238.58		66.60		15.98		50.16		17.71	

Source: Bureau of the Census, *1957 Census of Government*, Advance Release No. 8, February 1959.

TABLE XXII (*Continued*)

Tax revenues				Revenue for federal aid				Net long term debt		Interest on general debt		Personal income	
Per capita		Per $1,000 of personal income		Per capita		Per cent of general revenue		Per capita		Per $1,000 of personal income		Per capita	
Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank	Amt.	Rank
$100.94	2	$ 76.52	12	$32.16	36	19.9%	46	$167.11	12	$2.86	26	$1,324	5
169.86	30	92.10	29	31.25	34	12.8	27	273.28	32	1.84	10	1,750	20
100.40	1	87.82	22	28.38	30	18.8	45	149.15	9	3.47	36	1,151	2
237.87	48	93.98	32	33.51	38	10.7	18	274.97	35	2.28	14	2,523	45
188.71	41	93.99	33	40.02	43	14.8	36	274.72	34	2.59	21	1,996	33
204.77	44	73.15	7	13.38	4	5.4	2	401.18	43	3.13	29	2,821	48
135.37	12	48.96	1	18.78	14	9.1	12	498.07	48	3.40	35	2,740	47
159.45	24	89.22	25	21.25	17	9.7	15	273.85	33	3.72	39	1,836	25
123.93	9	86.43	21	25.75	26	14.3	32	207.89	23	3.23	33	1,431	8
155.00	21	95.85	37	36.27	39	16.0	37	141.21	6	1.57	8	1,630	14
179.48	35	73.83	9	15.06	5	6.9	6	277.09	36	3.01	28	2,447	43
141.68	15	70.09	5	12.54	2	6.8	5	168.90	14	2.21	12	2,010	34
176.33	33	97.06	41	22.27	19	9.7	16	113.19	3	1.25	2	1,806	23
176.24	32	96.96	39	27.63	29	11.7	20	306.66	39	3.76	40	1,787	21
107.36	4	78.31	15	21.87	18	14.5	33	132.65	5	2.59	22	1,372	6
162.99	27	104.02	44	38.28	40	14.7	35	321.48	40	5.93	48	1,566	12
154.56	20	92.55	30	23.49	20	11.7	21	202.23	22	3.27	34	1,663	16
158.02	23	73.29	8	17.90	10	8.6	11	446.37	45	4.67	46	2,156	39
210.20	45	89.31	26	18.21	11	7.2	8	406.08	44	4.09	44	2,335	41
181.13	37	83.54	18	18.55	13	7.9	9	220.24	25	2.48	20	2,141	38
179.71	36	97.04	40	23.88	24	9.8	17	185.48	15	2.47	19	1,850	26
108.58	5	112.37	47	27.28	28	17.0	41	130.90	4	3.89	43	958	1
130.49	10	66.98	2	30.24	33	16.7	40	155.83	10	1.66	9	1,940	31
187.78	39	99.76	42	48.84	45	17.7	44	198.12	20	2.77	24	1,896	28
140.72	14	76.60	13	23.50	22	12.0	22	336.88	41	1.44	4	1,818	24
229.24	46	92.83	31	62.36	46	17.4	42	243.49	28	2.23	13	2,423	42
152.19	17	81.88	17	18.24	12	9.3	13	192.65	19	2.40	17	1,862	27
174.19	31	69.45	4	9.97	1	4.7	1	375.94	42	4.19	45	2,504	44
157.55	22	91.56	28	66.68	47	22.5	47	227.36	26	2.44	18	1,686	18
229.31	47	90.41	27	15.74	6	5.6	3	472.86	47	4.97	47	2,578	46
112.55	7	84.96	20	26.25	27	16.1	38	159.32	11	2.85	25	1,317	4
166.65	29	116.33	48	31.96	35	12.3	24	101.13	2	1.93	11	1,435	9
152.98	18	67.88	3	15.99	7	8.0	10	265.87	30	2.71	23	2,255	40
153.71	19	94.10	34	40.75	44	17.5	43	233.41	27	3.14	31	1,619	13
200.68	43	103.33	43	38.53	41	13.9	30	212.45	24	2.39	16	1,914	29
160.98	25	75.98	11	12.70	3	6.4	4	298.45	37	3.80	41	2,112	36
151.82	16	75.87	10	23.52	23	12.2	23	266.61	31	3.49	37	1,990	32
103.88	3	87.98	23	19.76	16	13.2	29	167.70	13	2.94	27	1,180	3
164.83	28	106.26	46	39.73	42	16.4	39	66.23	1	0.72	1	1,531	10
118.12	8	84.88	19	23.50	21	14.2	31	258.50	29	3.14	30	1,383	7
137.01	13	76.82	14	25.47	25	12.8	26	298.57	38	3.80	42	1,791	22
162.72	26	94.79	36	33.25	37	14.5	34	187.99	16	1.30	3	1,694	19
177.38	34	104.84	45	29.72	31	13.0	28	147.58	7	1.54	6	1,665	17
131.62	11	79.95	16	17.29	9	9.6	14	198.78	21	3.18	32	1,660	15
188.15	40	88.51	24	29.73	32	11.2	19	466.01	46	2.33	15	2,128	37
112.08	6	71.64	6	19.13	15	12.7	25	192.33	18	3.49	38	1,554	11
184.47	38	95.90	38	16.24	8	7.1	7	148.76	8	1.55	7	1,920	30
191.79	42	94.40	35	84.88	48	24.8	48	189.35	17	1.47	5	2,038	35
160.22		88.86		24.68		12.5		216.34		2.81		1,827	

HOW FULLY DO FARMERS REPORT THEIR INCOMES?

FREDERICK D. STOCKER AND JOHN C. ELLICKSON *

Introduction

AMONG tax people there is wide agreement that farmers greatly underreport their incomes for tax purposes. This view finds support in various studies in which farm entrepreneurial income (income of sole proprietors and partners), as reported to the Internal Revenue Service, is compared with realized net income of farm operators from farming, as estimated by the U. S. Department of Agriculture.[1] More recently, Professor Harold M. Groves has thrown new light on the matter by following a different approach, by which he compares net farm income reported on a selection of Wisconsin state income-tax returns with income information for the same farmers obtained by interview and from other sources.[2] All these studies have indicated substantial understatement of farm income, although they differ somewhat as to its degree.[3]

One wonders nevertheless why tax compliance should be less complete among farmers than among other taxpayers whose incomes are not subject to withholding of taxes. In matters other than taxes, the prevailing view is that the farmer is at least as honest and scrupulous as his city cousin. Of course, it is well known that on the average incomes of farmers are lower than those of nonfarm people. This means that fewer farmers are actually subject to tax. But if there is a peculiar tax problem, as opposed to the problem of low incomes, its cause must lie deeper.

The explanation often given for the supposed negligence of farmers in tax matters runs in terms of the inadequacy of farm financial records. Farmers' records of income and expense, it is held, are typically such that it is impossible for the tax collector—and perhaps for the farmers themselves—to determine

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1 Selma F. Goldsmith, "Appraisal of Basic Data Available for Constructing Income Size Distributions," *Conference on Research in Income and Wealth* (New York: National Bureau of Economic Research, 1951), Vol. 13, pp. 267-377; Daniel M. Holland and C. Harry Kahn, "Comparison of Personal and Taxable Income," Joint Committee on the Economic Report, 84th Congress, 1st Session, *Federal Tax Policy for Economic Growth and Stability*, 1955, pp. 313-338; Marius Farioletti, "Some Income Adjustment Results from the 1949 Audit Control Program," *Conference on Research in Income and Wealth* (Princeton: National Bureau of Economic Research, 1958), Vol. 23, pp. 239-384.

2 Harold M. Groves, "Empirical Studies of Income Tax Compliance," *National Tax Journal*, XI (December 1958), pp. 291-301.

3 Mrs. Goldsmith estimated the proportion of farm net entrepreneurial income reported on Federal income-tax returns in 1945 to be 36 per cent; Holland and Kahn, using the same method, estimated 38.5 per cent for 1947; the Groves study, using state tax returns, found a reasonable range to be 60 to 75 per cent; Farioletti found that audit of a sample of farm sole proprietor returns disclosed 23.1 per cent additional net profit (minus loss).

their true income. The farmer is pictured as an unsophisticated businessman (if indeed that term can be used) who operates out of the hip pocket of his overalls and keeps accounts in his head, and whose mind is untroubled by any distinction between business and personal affairs.

At one time such a view may have been valid. But how accurate is it today? Few aspects of the farm business have remained unchanged in the last 20 years. Advances in farm technology have revolutionized farm production methods. Major innovations have occurred in the use of farm machinery, fertilizer, insecticides, irrigation, and hybrid varieties of crops and livestock. Introduction of these new farming practices has increased greatly the optimum size of an ordinary farm business and has called for corresponding changes in farm business methods. Today, operation of a typical commercial farm involves much the same kind of business and financial management practices as are used in small business in other industries.

If farm record-keeping has developed along with other farm business practices, and indications are that it has, it is time to reexamine our time-honored notions about income-tax compliance of farmers.

In an effort to determine the approximate extent to which farmers report their incomes on tax returns, we have brought together data on farm income and expenditures in 1955 from a variety of sources in the Department of Agriculture. Some of these data are drawn from published reports of the Department, chiefly from a report of a 1955 survey of farmers' expenditures,[4] and some from others that have not been published. We believe that, if certain adjustments are made, Internal Revenue Service statistics on total receipts from farm businesses can be compared with U. S. Department of Agriculture statistics on cash receipts from sales of farm products, and that this comparison gives at least a rough indication of the extent to which farmers comply with income-tax regulations.

Our analysis differs from the studies previously cited in that we are here concerned primarily with the reporting of gross rather than net farm income, as the data on gross income are more directly comparable. We do not attempt to determine the extent to which net farm income is reported. Nevertheless, some implications emerge with respect to this more critical question. Our comments on this point, however, must be regarded as tentative.

Farm Income and the Tax Laws

Unlike the income tax in many foreign countries, our federal income tax has always applied to income from agriculture exactly as it does to income from other types of business. Yet for many years very little farm income actually was taxed. Low average incomes and a relatively high exemption level served to exempt most farmers from the tax. In 1939, for example, a husband and wife ordinarily were not required to file a return unless their combined net income amounted to \$2,500 or more, or their gross income exceeded \$5,000. In that year, only about 250,000 of the more than 6 million farm operators produced farm products worth as much as \$5,000, and the num-

[4] U. S. Agricultural Marketing Service, *Farmers' Expenditures in 1955*, U. S. Department of Agriculture Statistical Bulletin 224, December 1956.

ber of operators having cash sales in that amount was even smaller. Not all who met the gross-income test had net incomes large enough to be taxable. But some of those who received less than $2,500 net income from farming earned enough from off-farm work to bring their total income above the amount of their exemptions.

The Internal Revenue Service reports that 140,000 tax returns of 1939 income were filed by sole proprietors of farms, 18,000 by farm partnerships, and 7,834 by farm corporations.[5]

3 times as large. During the same period, the number of farms dropped off by one-third, so that average income per farm has shown an even sharper rise (Table I).

To these influences must be added the effects of steadily increasing commercialization in agriculture. In 1939, about 28 per cent of farmers' realized net income represented farm products consumed directly in the farm household, but by 1957 this proportion had dropped to 16 per cent. Not only are farmers now receiving a larger part of

TABLE I

SELECTED MEASURES OF FARM INCOME, 1939–58

	Unit	1939	1940	1945	1950	1955	1957	1958[a]
Cash receipts[b]	Billion dollars	8.6	9.1	22.4	28.8	29.8	30.8	33.0
Realized net income ...	do.	4.4	4.3	12.9	13.2	11.5	10.8	13.0
Number of farms	Million	6.4	6.4	6.0	5.6	5.1	4.9	...
Cash income per farm ..	Dollars	410	386	1,604	1,438	1,539	1,557	...

[a] Preliminary.
[b] Includes Government payments.
Source: U. S. Agricultural Marketing Service, *The Farm Income Situation* (FIS 169), July 1958.

Since 1939, although the total number of farmers has declined, the number of farmers who are subject to income taxes has increased steadily. This rise is due partly to changes in the income-tax law; the minimum gross income on which a return is required now stands at $600 ($1,200 if the taxpayer is 65 years old or older), and personal exemptions have been reduced to that figure. But changes in the agricultural economy have also been significant. Farm income has increased enormously since 1939. Gross cash receipts from farm marketings in 1958 were almost 4 times as large as in 1939, and realized net income was

their incomes in actual cash, but with growing specialization in agriculture, more and more of them are receiving their incomes in a few large payments from one or two main sources, rather than in many small driblets.

Along with these changes has come widespread application of business management methods to farm operations, including the keeping of careful financial records. It is not uncommon today for a family-sized farm to gross as much as $25,000 annually and to have capital assets amounting to $50,000 or more. The operator of such an enterprise can ill afford to keep his accounts on the backs of old envelopes.

Finally, the introduction of social security for farm operators has given a

[5] Bureau of Internal Revenue, *Statistics of Income, 1939*, Parts 1 and 2. Not all these returns were taxable.

strong incentive to the holdouts, especially among the older farmers, to file income-tax returns. The number of farm income-tax returns increased by nearly 300,000 between 1953 and 1955, the first year when farmers had an opportunity to participate in the social-security program (Table II).[6]

TABLE II
NUMBER OF FEDERAL INCOME-TAX RETURNS SHOWING INCOME FROM FARM BUSINESS, SELECTED YEARS, 1939–55

Year	Sole proprietors of farms	Farm partnerships	Agricultural corporations	Total
	(In thousands)			
1939	140	18	8	185
1945	2,659	97	6	2,762
1947	2,904	114	7	3,025
1949	2,987	...	7	....
1951	3,139	...	8	....
1953	3,126	135	9	3,270
1955	3,417	...	9	....

Source: Internal Revenue Service, *Statistics of Income*, for individuals, partnerships, and corporations, for corresponding years.

As a result of the combined action of all these forces, by 1955 the number of federal income-tax returns that show income from a farm business had increased to a total of more than 3½ million.

Farm gross receipts reported on tax returns have increased along with the number of returns. In 1939, farm business receipts reported on income-tax returns amounted to only \$2.0 billion, or less than one-fourth of the Department of Agriculture estimate of cash receipts from marketings of farm products (Table III). By 1955, this total had grown to \$25.8 billion, a figure that compares rather closely with the corresponding USDA estimate of \$29.8 billion. Thus, on the face of the matter, it would appear that receipts reported on tax returns have increased remarkably as a proportion of total received by farmers and that the proportion now approaches 90 per cent.[7]

The obvious objection to such a comparison as this is that there are important conceptual differences between farm business receipts as they are reported on income-tax returns and the USDA estimates of cash receipts from sales of farm products. Anyone familiar with these data is aware that there are such differences, but seldom have they been thoroughly specified and never to our knowledge have approximate dollar magnitudes been assigned to all of them. This is the problem to which we now turn.

Reconciliation of Gross Income Statistics

The differences between IRS and USDA statistics shown in Table III may be grouped under two headings. One group consists of items included in the USDA estimates of cash receipts from farm marketings that are not classified on income-tax returns as ordinary receipts from farm business.

[6] An interesting finding of the AMS survey of farm expenditures is that in 1955, 2,068,000 farm operators (44 per cent of the total) paid a total of \$26,115,000 for assistance in preparation of income-tax returns. (*Ibid.*, Table 4, p. 26.)

[7] For purposes of tabulation, the Internal Revenue Service classifies partnership and corporation returns by industries according to the principal source of receipts. Consequently, some receipts from farm business are reported under other industrial categories, while the amounts reported under "farm" businesses include some receipts derived from nonfarm activities. It is assumed here that these two items offset each other. However, as the farming operations of such mixed enterprises are likely to be a minor adjunct to other activities (rather than the other way around) this assumption probably understates the farm receipts actually reported to IRS.

The other consists of certain types of farm business receipts that show up on tax returns but are not part of the USDA totals.

Our first adjustment is for receipts from farm marketings that are treated as capital gains for tax purposes. Receipts to farmers from sales of livestock held for draft, breeding, or dairy purposes, are included in the USDA totals, but the Internal Revenue Code classes them as gains or losses on sales of capital assets. The noncorporate taxpayer would report them on Schedule D of his individual income-tax return. These receipts accordingly would not appear in the IRS totals of farm receipts, which are tabulated from "F" (farm) and "C" (business) schedules.

Unpublished data of the Agricultural Marketing Service indicate that in 1955 the commercial slaughter of breeding cattle, sheep, and hogs had a live value of about $1.3 billion. To this should be added an allowance for sales of animals for breeding and other purposes besides slaughter, so that the total of such receipts eligible to be treated as capital gains is probably at least $1.5 billion. If an allowance is made for some inadvertent reporting of this item as ordinary farm income, it appears that perhaps two-thirds, or $1 billion of receipts from livestock sales are reported as capital gains and are not included in IRS total farm receipts.

A second partial omission from the IRS total consists of farm production received by landlords as share rent. According to the study of farmers' expenditures, farm operators paid $2.8 billion dollars in share rent in 1955.[8] There is no hard and fast rule as to the method of reporting share rents on tax returns. Many landlords enter this income on the "G" or gross rent schedule. Many others report it on Schedule "F" as receipts from farm business. The latter form of reporting is more convenient for the landlord who operates a farm of his own and fills out an "F" schedule on his own receipts and expenses and who perhaps markets his

TABLE III

Receipts from Farming, 1939–55

(In millions of dollars)

Year	Reported to Internal Revenue Service: Sole proprietors	Partners	Corporations	Total	United States Department of Agriculture estimates [a]	IRS total as percentage of USDA [b]
1939	$ 1,216	$ 293	$ 528	$ 2,037	$ 8,635	24%
1941	4,986	....	663	.....	11,655	54 [c]
1943	11,504	....	787	.....	20,265	68 [c]
1945	14,227	1,713	885	16,825	22,404	75
1947	18,380	2,582	1,528	22,490	29,978	75
1949	18,993	....	1,768	.....	28,050	83 [c]
1951	22,093	....	2,234	.....	33,213	82 [c]
1953	21,317	2,833	2,217	26,367	31,396	84
1955	20,779	....	2,373	25,840 [c]	29,771	87 [c]

[a] Including government payments.

[b] These comparisons do not take account of differences in concept and coverage. Table 4 shows the reconciliation of these differences for 1955.

[c] Estimated.

[8] Agricultural Marketing Service, *op. cit.*, Table 12.

rental share along with his own farm products. As a result, much of the $2.8 billion in share rent does find its way into the IRS totals as farm business receipts. A small part—perhaps a fourth, or $0.7 billion dollars—is a conservative allowance for the amount reported to IRS in the form of rental income.

The third item included in the USDA estimates but not in the corresponding IRS totals consists of certain receipts that are offset by marketing costs. The Department of Agriculture measures the value of cash farm marketings at the point of first sale. But a lower value may properly be reported on the tax return. A dairy farmer, for example, who produces and sells $1,000 worth of milk per month, may receive a month-end check from the dairy or marketing coop for only $960. The $40 difference represents charges for hauling and other expenses. The farmer normally enters on his tax returns only the net amount he receives, in this case $960. Conventional methods of marketing cotton and livestock give rise to similar deductions.

The AMS survey of farm expenditures for 1955 reports $189 million paid by farmers for trucking dairy products to market, $191 million for ginning, grading, and storing cotton, and $207 million for yardage and brokerage fees on livestock. Of course, some farmers may include these costs on tax returns as a deductible expense and report the gross amount obtained for these products as receipts. On the other hand, there are some other commodities not taken into account here that also involve marketing costs chargeable to the farmer. Consequently a net reduction of $0.6 billion from the USDA total appears to be reasonable adjustment.

These three items—capital gains, share rents, and marketing costs—together account for $2.3 billion of farm marketings that do not show up in the IRS totals of farm business receipts.

Adjustments must be made in the opposite direction for receipts included in the IRS returns but not in the corresponding USDA figures. The first is for miscellaneous business income, such as that obtained by farmers from custom machine work on other farms, crop-insurance indemnities, and sales of sod, gravel, topsoil, and scrap metal. The AMS survey shows that in 1955, net receipts of farm operators from custom machine work and farm trucking and hauling amounted to $300 million. Loss payments for hail and other damage to growing crops were about $70 million. With a liberal allowance for all other items of miscellaneous income that might be reported on a farm business schedule, our estimate of the total comes to $0.5 billion.

Dividends and refunds paid to farmers by farm cooperatives are also included in tax reports to IRS but omitted from USDA estimates of receipts. A 1954 survey by the Farmers Cooperative Service found that a total of $225 million in patronage dividends was paid or credited in that year to farmers by farm marketing or supply coops. In 1955 the amount was probably a little larger. A portion of patronage dividends, like share rents, must be attributed to landlords, but the amount is probably small. Accordingly, an allowance of $0.2 billion appears to be reasonable for this item.

Included in the IRS classification of agricultural corporations are domestic companies that produce bananas, sugar, and other crops in foreign countries. On the basis of information pieced to-

gether from IRS reports, Moody's Investors' Service, and other sources, a deduction of $0.6 billion is made from the IRS total to adjust for receipts of these corporations that are reported to IRS but are not included in the USDA estimates.

Also omitted from the USDA totals are intrastate farm-to-farm sales of livestock. Information on these sales is not amount should be added to the USDA estimate to arrive at a comparable figure for the value of total farm marketings.

Finally, the census of agriculture for 1954 reports a value of commercial farm production of almost $300 million in Hawaii and Alaska. As income-tax returns from these areas are included in the IRS totals, this amount is added to the USDA estimate of cash farm marketings.

TABLE IV
RECONCILIATION OF INTERNAL REVENUE DATA ON FARM BUSINESS RECEIPTS WITH USDA ESTIMATES OF CASH FARM MARKETINGS AND GOVERNMENT PAYMENTS, 1955
(In billions of dollars)

Internal Revenue	*Adjustments*		USDA	*Adjustments*	
Farm receipts		25.8	Cash marketings		29.6
			Government payments		.2
			Total		29.8
Add:			Add:		
Capital gains	1.0 *		Intrastate livestock sales	.9	
Crop share rents	.7 *		Farm production in Hawaii and Alaska	.3	1.2
Marketing costs	.6	2.3			
Deduct:					
Custom work, etc.	.5				
Patronage dividends	.2				
Corporation receipts from foreign areas	.6	1.3			
Subtotal		26.8			
Residual, not accounted for		4.2			
Total		31.0	Total marketings and government payments		31.0

* These estimates should be recognized as resting on less firm statistical underpinnings than the other adjustments (see text). The appropriate allowances could be less than our estimates, but certainly not zero. More likely, we believe, the true amounts are greater than we have estimated.

regularly available. Nor does their omission appreciably affect the USDA estimates of net farm income, as the receipts to the seller are offset by the outlays of the buyer. But for income-tax purposes, receipts from these sales are reported in the same way as those from other livestock sales. The AMS survey reports the value of such intrastate livestock sales in 1955 as $936 million. This

If the amounts we have used in making the various adjustments for differences in coverage and concept are accepted as rough approximations, and they are intended as nothing more precise than that, it would appear that federal income-tax returns for 1955 accounted for about $26.8 billion of a possible $31.0 billion total of farm receipts (Table IV). This works out to

86.5 per cent, or about the same proportion as in the unadjusted comparison (Table III). The adjustments, in other words, have approximately offset one another.

This leaves $4.2 billion, or 14 per cent of the total, not accounted for. But not all of this represents evasion. Some of these receipts were reported on late returns, which are not taken into account in our comparisons. Some, too, were received by farmers whose gross income fell short of the $600 minimum filing requirement. Much larger would be the receipts of farmers whose gross incomes exceeded $600, but whose net incomes, after exemptions and nonbusiness deductions, were not taxable. There is some evidence that many farmers in the latter category ignore the filing requirement, and IRS stands to gain very little from efforts to force them to file.

Extent of Income-Tax Coverage

Our analysis suggests that income-tax coverage of gross farm income has increased greatly since before World War II, and that it is now fairly complete. In 1939, it could be said with substantial accuracy that farm income, by and large, escaped the income tax. Few farmers then needed to concern themselves with the income tax and all that it involves. But along with the war came increased farm incomes and extension of the tax downward into the lower income brackets so that farmers lost their *de facto* immunity. It may well have taken some time for farmers to accustom themselves to their new status as income-tax payers. But our evidence indicates that by 1955 the bulk of all farm receipts that in principle were subject to tax were actually being reported on federal income-tax returns.

Not everyone, we recognize, will accept this conclusion. Some will simply not believe it. The question inevitably must arise whether our analysis may perhaps have gone wrong somewhere. Without denying the possibility of a mistake, we have tried to anticipate a few of the obvious questions that could be raised.

Thus, one might object to the lack of precision in the adjustments we have made to reconcile total farm business receipts reported to the IRS with the corresponding USDA figures. Some of our estimates are admittedly rough. But in many instances, they involve allocation of a total that is known with some accuracy so that the margin of error is limited.[9] Moreover, it is not necessary to claim any great degree of precision, only that the adjustments are required for conceptual uniformity, that they are in the right direction, and that they are approximately of the right magnitude. Nor should one lose sight of the fact that many of the adjustments do rest on good statistical evidence.

But what of the possibility that our estimates may all err in the same direction? To meet this problem we have attempted, within the range of plausible guesses, to stay on the conservative side in estimating amounts that should be added to the IRS totals, and on the liberal side in estimating those that need to be added to the USDA totals (or subtracted from the IRS). As a result, we believe that the estimate of 86 per cent

[9] For example, in the adjustment for landlords' share rents we have had to decide how much of the $2.8 billion total was reported on the "G" schedule. We estimated the amount conservatively at $0.7 billion. On the unlikely assumption that none of this was reported as rental income, our estimate of 86.5 per cent would have been reduced to 84.2 per cent.

is more likely to be too low than too high.[10]

One may wonder, too, whether some large item may not have been overlooked. This possibility can never be ruled out absolutely although, obviously, no such omission has so far come to our attention.

Finally, there is the possibility that the Department of Agriculture estimates of gross farm income may be too low. Neither can this possibility be discarded definitely. Available evidence, however, argues against it. The official data on gross farm income tie in well with other statistical data about farms and farm people. Any sizable departure from these aggregates would introduce many puzzling anomalies and inconsistencies.[11]

Implications for Tax Enforcement

If it is probable, then, that some 86 per cent of all receipts from sales of farm products is indeed reported on federal income-tax returns, there are some implications for income-tax compliance and enforcement.

It would appear, first of all, that the enforcement efforts of the Internal Revenue Service, including information and educational programs directed toward farmers,[12] have achieved substantial success. One of the last large economic groups to remain essentially untouched by federal income taxation has apparently been brought under the tax. Surely, this marks a significant advance in the development of tax administration and the maturing of our tax system.

In light of these indications of fairly complete reporting of farm gross income, one cannot help wondering about the reporting of net income. It follows from our argument that to the extent there is any widespread underreporting of net income by farmers or underpayment of taxes, the cause probably does not lie in the omission of gross receipts. Rather it would have to come from overstatement of deductions or personal exemptions. There is no self-evident reason for believing that farmers differ from taxpayers in other industry groups in the extent to which they exaggerate nonbusiness deductions or claim too many dependents. The temptation to this form of evasion probably does not follow occupational lines.

With respect to deduction of business expenses, it is readily apparent that the nature of the farm business involves difficulties in distinguishing personal from business expenses, and that some personal expenses may well be deducted on farmers' returns. But this, also, is a problem not peculiar to farming. Instead, it has long been recognized as one that applies to all small business or professional firms, especially unincorporated ones.

On their face, the data contained in the various *Statistics of Income* appear to suggest that overstatement of farm operating expenses may indeed be prevalent. Corresponding to the $25.8 billion of total receipts reported in 1955 was a net profit (minus loss) of only

[10] Our data on receipts reported to IRS are also understated because (a) they do not include receipts reported on late returns and (b) they are based on a sample of unaudited returns.

[11] It may be noted in this connection that the AMS figures on gross receipts from cash farm marketings, though based on the census of agriculture, are adjusted upward to correct for underenumeration; thus, in 1954, the census of agriculture reported cash farm marketings (excluding government payments) at $24,644 million; the corresponding AMS estimate, $29,556 million, was 20 per cent greater.

[12] The IRS publication, *Farmers' Tax Guide,* has been a notable contribution in this area.

$3.2 billion. For that year, the USDA estimate of realized net income of farm operators from farming was $11.5 billion. About $3.8 billion of this was received in the form of nonmoney income, so that net cash income for 1955 was about $7.7 billion, or more than double the amount that showed up on income tax returns.[13]

But these comparisons do not take into account conceptual dissimilarities such as those examined above for gross farm receipts. This reconciliation, important though it is, is not attempted here. To compare USDA estimates of net income of farm operators from farming with the amounts reported to IRS as net profit on farm business, it would be necessary to reconcile the differing concepts of expenses. Many items that are properly deductible on the income-tax blank are not included in the USDA estimates of operating expenses —conservation outlays, for example. Estimates would need to be made, too, of such expenses as wages paid to family members, especially minors. The handling of depreciation would also need to be examined, along with the line dividing capital from current outlay. And the distinction between business and nonbusiness deductions would need to be drawn clearly. Problems arise also of identifying the population. In dealing with gross receipts, we have been faced only with the necessity of identifying a certain type of income. But a reconciliation of net income would require also a determination of the share of farm expenses incurred by farm operators, as opposed to landlords, and by members of the farm population as opposed to those not living on farms. An expedition into this statistical morass would require adventurers more courageous than the authors of this paper.

Although our analysis does not extend to operating expenses, it may nevertheless be worth noting that overstatement of deductions is seldom alleged to be the main cause of underreporting of net farm income. The usual criticism emphasizes omission of gross receipts, or failure to file a return at all. This form of noncompliance is what one would normally expect on the assumption that farmers' financial accounts consist mainly of nothing more than jottings on the calendar. As indicated earlier, however, reliance on such primitive accounting methods is becoming less common and is probably now rare among operators of large farms—that is, the million or so who together account for about three-fourths of all farm products marketed.

Moreover, there is some cause for suspecting that poor records, instead of leading to understatement of income, often result in overreporting. Researchers and agricultural extension specialists who work with farm-account records believe that inadequate accounts omit more expenses than they do income. Even with poor financial records, it is fairly easy for a farmer to maintain a record of his gross income. With the trend toward greater specialization in agriculture, many farmers receive their income in fewer and larger payments, usually by check, and from only a few main sources. But farm operating expenditures go out in many small payments and farmers are likely to forget about some of them. The Federal Extension Service, through its system of county agricultural agents, has long urged farmers to keep better books, partly on the ground that by doing so

13 Part of the discrepancy represents receipts reported to IRS as capital gains.

they may save themselves money on their income taxes.[14]

Of course, none of this evidence proves anything with respect to the reporting of net farm income. At best it suggests that if farm gross income is reported rather fully on federal income-tax returns, the same may well be true of net income. It does seem clear that reporting of gross farm income today is substantially complete, whatever the situation may have been two decades ago.

We conclude therefore that, whatever the situation may have been 20 years ago, the farmer today is probably much the same sort of taxpayer as is found in other industries, not much better and not much worse. It is not necessary to argue that all farmers report their gross incomes to the last penny on their income-tax returns. Some undoubtedly do not. But it appears that in farming as elsewhere, unreported receipts do not amount to much in the aggregate. Nor is it possible to deny that some personal outlays of farmers are deducted as business expenses. Here too, however, the amount involved is probably small. In any case, the problem can be recognized for what it is—part of the larger problem of distinguishing the business expenses of small unincorporated businesses, whatever the industry, from the personal expenses of the owners.

[14] Groves states with respect to his findings of substantial under-claiming of expenses by farmers: "We thought this incredible at first, but we found it in accord with a substantial body of opinion including that of the personnel in the office of the Management Association and some of the intermediaries (those who assist farmers in preparing income tax forms) whom we interviewed" (*op. cit.*, p. 300). He later terms this the most striking fact disclosed by the study (p. 301).

THE FINANCE OF LOCAL GOVERNMENT IN ENGLAND AND WALES SINCE 1948: Part III

ALAN WILLIAMS *

In Part I of this study a survey was conducted of the major quantitative changes that have taken place since 1948 in local-government finance in England and Wales. This survey indicated the need for isolating the following main topics for more detailed consideration:

(1) Is it practicable and desirable to increase the relative share of rates in the revenues of local authorities?

(2) Is it practicable and desirable to find some new sources of local revenue?

(3) Is it practicable and desirable to change the present balance between general and specific grants?

(4) Is it practicable and desirable to use grants to equalize the fiscal resources of local authorities?

(5) Is it practicable and desirable to regulate local authorities' capital expenditure by controlling their access to outside funds?

The first three of these questions were taken up in Part II in the last issue. In this part I will examine the last two questions, reach final conclusions regarding local-government financial problems in England and Wales, and append a bibliography.

III. THE MAJOR ISSUES (CONT.)

4. *Equalizing Grants*

Throughout the preceding discussion we have ignored, for the most part, variations between authorities in entitlement to grants, devices in grants to discriminate between " rich " and " poor " authorities, and grants especially designed to reduce such differences in " wealth." These are not unimportant omissions, for much of the concern that is expressed about local-government finance stems from the wide regional and structural disparities between needs and resources. It was necessary, however, to keep our earlier discussion of the rating system and the grant structure as free as possible of such considerations, in order that we might be able to examine them in as general a framework as possible, for what we have said so far would still apply even if the present system were purged of the complications that we are now going on to discuss.

In Part I of this study we described briefly some of the major sources of variations in relative needs and resources between regions and authorities. In attempts to find a convenient index of the disparities in resources between authorities, it is common to take, as an absolute measure, the yield of a rate of one penny per £ of rateable value in each authority after allowing for costs of collection, and losses from unoccupied premises. Some indication of the marked disparities here can be obtained from a consideration of Table X. A factor based on this rating yield is often used as a negative element in a grant formula, such as in both the Education Main Grant and the new General Grant. It acts to reduce the grant entitlement of " rich " authorities relatively more than that of " poor " ones. In both of these grant formulae, population or expenditure are taken as an index of needs

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and enter as positive terms. Thus these grant formulae contain two separate groups of terms, one reflecting needs and one reflecting resources. Sometimes, however, one composite term is introduced in order to serve both of these purposes simultaneously, and the most important of these has been "rateable value per head of weighted population." Weighted population differs from ordinary population in that children under 15 are counted twice, with some further adjustments for sparsity of population. This is taken as the "needs" component. Rateable value is then the "resources" component, closely related, obviously, to "rate yield" determined above. The distribution of rateable values per head of weighted population (RV per head) in recent years is shown in Table XI. This element has been the basis of the Exchequer Equalisation Grant.

The Exchequer Equalisation Grant

The Exchequer Equalisation Grant (EEG) was introduced in 1948, and has been the only grant not allocated to any specific service. Basically what this grant has done is to ensure that every authority is brought up to the national average in terms of rateable value per head of weighted population. With some simplifications[45] the grant formula

TABLE X

Estimated Yield from a Penny Rate per Pound of Rateable Value

Local authority	1955–6		1956–7 (In thousands of pounds)		1957–8	
England and Wales	£1,456		£2,480		£2,379	
London	239		419		376	
(61) Administrative counties	766		1,321		1,303	
(83) County boroughs	452		740		700	
Size of yield	**Number of local authorities**					
	A.C.	C.B.	A.C.	C.B.	A.C.	C.B.
£ 0–£ 4,999	25	60	16	37	16	40
5,000– 9,999	13	14	11	25	11	22
10,000– 19,999	14	6	13	15	13	15
20,000– 29,999	3	2	11	3	11	3
30,000– 39,999	1	1	3	1	3	2
40,000– 49,999	..	..	1	1	1	..
50,000– 99,999	5	..	4	1	5	1
100,000 and over	..	..	2	..	1	..
Median	£ 6,627	£3,453	£13,546	£ 5,610	£13,063	£ 5,310
Upper quartile	14,788	6,385	24,896	10,529	25,008	10,308
Lower quartile	2,563	2,180	4,643	3,659	4,581	3,430
$\frac{\text{Upper quartile} - \text{Lower quartile}}{\text{Median}}$	1.84	1.22	1.50	1.22	1.56	1.30

Source: Ministry of Housing and Local Government, *Rates and Rateable Values, England and Wales,* 1955/6, 1956/7 and 1957/8. A.C. stands for administrative counties; C.B. for county boroughs.

[45] For a much fuller treatment of this subject see "The Effects of the Local Government Act, 1948, and Other Recent Legislation on the Finances of Local Authorities," a series of reports by a working party under the chairmanship of L. T. Little and J. B. Woodham, published in *Accounting Research,* 1948, pp. 85-105 and 281-302; 1950, pp. 189-251; 1952, pp. 266-304; and 1953, pp. 1-29.

can be expressed thus:

Amount of Grant Payable =

$$\frac{\text{RLE}}{\text{ARV}+\text{CRV}} \times \text{CRV}$$

In this expression the RLE, Relevant Local Expenditure, means pretty well all current expenditure after deducting specific grants and adjusting for changes in reserves that fall on the local rates. ARV, Actual Rateable Value, is the total rateable value of the authority. CRV, Credited Rateable Value, is the amount of rateable value that would have to be added to the ARV to bring that authority's RV per head up to the national average. Authorities with RV per head above the national average do not qualify for EEG—they are the " non-receivers." But there is no reducing of rateable value: such authorities are just left to their own devices as far as grants that are explicitly equalizing are concerned.

For all the authorities that are " receivers," (ARV + CRV) per head of weighted population is brought into equality with the national average RV per head. Since it is expenditures over property-tax base that determines the rate poundage (rate of tax) of each authority, it is obvious that these tax rates will be directly proportional to RLE per head of weighted population for these authorities. Thus the EEG does not break the direct connection between levels of expenditure and levels of rate poundage.

A second important attribute of the EEG can be brought out quite clearly by rearranging the terms of the grant formula as given above, thus:

Amount of Grant Payable =

$$\frac{\text{CRV}}{\text{ARV}+\text{CRV}} \times \text{RLE}$$

If we now take RLE as fixed, it will be seen that the larger CRV relatively to ARV (i.e., the further the authority's RV per head falls below the national average) the greater the proportion of RLE financed by the EEG.

Criticisms of the Exchequer Equalization Grant

There have, then, been two methods of introducing equalizing devices into the grant system. The first consists of incorporating discriminating terms into the formulae of specific grants which are given to all authorities, and the second consists in setting up a special grant the sole purpose of which is to help the relatively " poor " authorities in the sense we have just described. Both methods attempt to relate resources to needs, though in different ways and according to slightly different criteria. Their combined effect has been rather odd, however, for it has meant that, on the one hand, all authorities are assured a certain " minimum subsistence level " of rateable resources, while, at the same time, entitlement to specific grants is varied (using a deduction for rating yield) as if this minimum did not exist.

A simple arithmetical example will bring this out clearly. Consider three authorities, each with a population of 10,000, a total expenditure of £200,000 of which half is financed by specific grants (before taking account of the rate-yield deduction factor) and half by rates. Let the national average RV per head be £10, and the RV per head of these three authorities £5, £10, and £15, respectively. We then have:

		A	B	C
(i)	Total rateable value	£50,000	£100,000	£150,000
(ii)	Rate poundage if no grants	80s.	40s.	26s. 8d.
(iii)	Specific grant (gross)	£100,000	£100,000	£100,000
(iv)	*Less* product of 2s. rate (ignoring costs and losses)	£5,000	£10,000	£15,000
(v)	Specific grant (net)	£95,000	£90,000	£85,000
(vi)	Leaving rateborne expenditure ..	£105,000	£110,000	£115,000
(vii)	Rate poundage, if no EEG	42s.	22s.	15s. 4d.
(viii)	Credited rateable value	£50,000	......	......
(ix)	Effective rateable value	£100,000	£100,000	£150,000
(x)	Rate poundage	21s.	22s.	15s. 4d.

The combined effect is that the ratepayers in the "poor" authority (A) end up better off than those in the "average" authority "B"![46]

Another important criticism of these equalization devices has been that they have leaned too heavily on rateable values, either directly or via rate products, as an index of wealth. In Section 1 above we have already described the notorious lack of uniformity between authorities in valuation practices, and, even after the recent revaluation, rateable values are still bedevilled by the differing bases of valuation employed for different classes of property. Moreover, it is clear that much of the dispersion in rateable values per head of weighted population (set out in Table XI) is due to derating, and especially to the derating of agriculture.[47] Since it is RV per head which determines entitlement to EEG, this grant must be seen in part as compensation for lost rate revenues due to derating. But this compensation is given only to those authorities whose RV per head has been brought by derating below the national average, an average which in turn is reduced by derating.[48]

There has been one further criticism of the treatment of the constituent authorities in administrative counties under EEG which should be mentioned briefly. The EEG was paid to the administrative county, with the RV per head for the county *as a whole* deter-

[46] This "double compensation" has been analysed in some detail by J. B. Woodham, *Education Rates and the Education and Equalization Grants* (London: Institute of Municipal Treasurers and Accountants, 1953), who reaches the following conclusion:

> In the absence of the equalisation grant, the education grant would give partial equalisation to all authorities. In the absence of the education grant the equalisation grant would give complete equalisation to all authorities with rateable values per (weighted) head below the national average. The two together give this curious but easily understood result. The authority with the lowest rateable value per head, other things being equal, would enjoy a low education rate poundage. As rateable value per head increased, so would the education rate poundage increase, *reaching its maximum for the authority with the average rateable value per head.* As rateable value per head increased still further, the education rate would start to decrease again because the equalisation grant would be no longer operative, whilst the 30d. rate product element would be too small to counteract the increase in resources. (pp. 55-6)

[47] See page 131.

[48] For a fuller analysis of the effects of derating upon the whole grant structure see the report published by the Society of County Treasurers in 1954 entitled, *The Abrogation of the Present System of Derating.*

mining entitlement or ineligibility to grant for all constituent authorities within the county, regardless of need. This meant, for instance, that a " rich " rural district in a " poor " administrative county would benefit from the EEG, while a " poor " rural district in a " rich " administrative county got nothing from it.

At this stage it would be admirable to be able to show the effects of all these measures upon the incidence of rates between regions and between authorities. Unfortunately it is impossible to do more than sketch out the effects in a rather unsystematic way, for, to my knowledge, no thoroughgoing analysis of this aspect of the matter has been conducted in recent years. On the basis of 1937 data, J. R. and U. K. Hicks estimated that the formal incidence of domestic rates as a percentage of gross household expenditure varied in the following way (Table XII): in agricultural areas they were much lower than in industrial areas (as was the level of local-government services, of course); in London and Wales they were higher than elsewhere (in the former case presumably because of high levels of service and in the latter because of low levels of income); in towns they increased with a less marked trend as the size of town increased. No comparable estimates are available that are based on more recent data.[49] Although considerable variations still persist in the rateable values attached to similar properties in different parts of the country [50]

[47] See my article, pp. 150-7, cited in footnote 9 above, where on the basis of 1953-4 data I then estimated that the complete abolition of all derating would have changed the distribution of rateable values per head of weighted population thus:

Rateable value per head of weighted population	County boroughs		Administrative counties	
	Actual 1953–4	If derating abolished	Actual 1953–4	If derating abolished
£14.00 to £14.99	1	1	..	..
13.00 to 13.99	..	..	..	..
12.00 to 12.99	1	1	..	..
11.00 to 11.99	1	2	..	..
10.00 to 10.99	2	2	..	1
9.00 to 9.99	2	2	1	5
8.00 to 8.99	4	5	3	7
7.00 to 7.99	10	24	..	18
6.00 to 6.99	17	26	4	20
5.00 to 5.99	28	16	14	9
4.00 to 4.99	15	3	22	1
3.00 to 3.99	2	1	12	..
2.00 to 2.99	..	..	5	..
Arithmetic mean ...	6.34	7.07	4.78	7.16
Standard deviation .	1.92	1.74	1.46	1.24

It will be noted that within each class of authority the dispersion diminishes, and at the same time the formerly wide disparity between the two classes themselves virtually disappears.

[49] Unfortunately the Ministry of Labour's 1953-4 Household Expenditure Survey does not show rates as a separate item, but only gross rents, which comprise rents, rates, and water charges. Comparison of regional variations in gross rents paid by tenants show that more or less the same regional pattern persists as in the 1937 data analyzed by the Hicks. But the over-all proportion of rates to gross rents has almost certainly risen—the 1952-3 Oxford Savings Survey yields a figure of 32 per cent while the 1937 data gives one of about 27 per cent. Since these increases cannot be assumed to be uniform throughout the country, the finding does not carry us very far.

[50] Even after the 1956 revaluation, the rateable values of the virtually identical temporary (prefabricated) bungalows put up after the war to ease the housing shortage varied in County Boroughs from £8 to £30 (with the median at £16), in the North from £11 to £22 (median £14), in the Midlands from £12 to £22 (median £16), in the South £18 to £30 (median £21), and in Wales from £8 to £19 (median £15). It should be noted, however, that part of this variation was due to differences in site values, for within individual authorities variations as wide as £11 to £17 and £22 to £30 are reported. See *The Rating of Dwellings—History and General Survey* (London: Institute of Municipal Treasurers and Accountants, 1958), Table 8, p. 85, for the source of this information, and for a fuller discussion of its implications.

in rate poundages or tax rates (Table XIII), and in regional income levels,[51] there is good reason to suppose that each of these shows less variation today than twenty years ago. It seems reasonable to guess, therefore, that regional variations in the formal incidence of rates are now less marked than in 1937.

The Rate Deficiency Grant

The latest proposals for the reform of local-government finance do meet some of the criticisms of the Exchequer Equalisation Grant that have just been mentioned. For instance, the amended EEG, renamed Rate Deficiency Grant (RDG), is to be payable in part directly to the constituent authorities in administrative counties. There is also some minor adjustment of the grant formula to meet some anomalies that had arisen in the treatment of costs of collection, and the double counting of children in " weighted population " has been abandoned now that this factor plays such an important part in the new General Grant. But the most interesting features of the new scheme from our point of view are the proposal to incorporate a device to limit entitlement to grant, and the absence of any adjustment to counteract the " double compensation " anomaly that was described above. Each of these points will be considered in turn.

The introduction of the limiting device is prompted by the variable " percentage " nature of the grant analysed on p. 129 above. The proportion of Relevant Local Expenditure financed by the EEG has been as high as two-thirds.[52] Since RLE is the balance of local expenditure *not* financed by specific grants, in some authorities Exchequer grants have loomed very large on the revenue side of

[51] The Ministry of Labour's Household Expenditure Survey gives the following estimates of Gross Household Weekly Incomes and Average Expenditure by Regions for 1953-4 as follows (amounts shown in thousands):

Gross household weekly income (Table 4, p. 17)	London		South		Midland		North		Wales	
	Number	Per cent	Number	Per cent	Number	Per cent	Number	Per cent	Number	Per cent
£14 and over	832	40.4%	540	26.1%	928	32.0%	1,034	30.2%	189	27.5%
£8 but under £14	819	39.8	934	45.2	1,231	42.4	1,456	42.5	282	41.0
Less than £8	409	19.9	590	28.6	743	25.6	932	27.2	217	31.5
Total	2,060	100.0%	2,064	100.0%	2,902	100.0%	3,422	100.0%	688	100.0%
Average weekly expenditure	264s. (Table 33, p. 164)		230s. (Table 34, p. 169)		239s. (Table 32, p. 159)		236s. (Table 31, p. 185)		241s. (Table 35, p. 174)	

Compare this with the 1937 data given by J. R. and U. K. Hicks, *The Incidence of Local Rates*, Table 2, pp. 12-13:

<table>
<tr><th>Average annual family expenditure</th><th>London</th><th>S.E.</th><th>S.W.</th><th>Midland</th><th>N.E.</th><th>N.W.</th><th>N.</th><th>Wales</th></tr>
<tr><td>Industrial households</td><td>£243</td><td>£204</td><td>£207</td><td>£237</td><td>£216</td><td>£223</td><td>£207</td><td>£207</td></tr>
<tr><td>Agricultural households</td><td colspan="2">£150</td><td colspan="2">£146</td><td colspan="3">£157</td><td>£148</td></tr>
</table>

the account, and the EEG has acquired a significance in relation to other grants much greater than would be indicated simply by comparing the aggregate amounts dispensed in this way with the aggregate amounts dispensed as specific grants (see Table III, Part I).

An official committee (the " Edwards Committee ") was appointed to investigate the operation of the EEG in England and Wales and issued a report in 1953. In it they stated that " there is no present evidence that the form of the grant has induced extravagance on the part of local authorities receiving it." [53] Nevertheless, they felt that the inducement remained, and that with a general loosening of central control " some limits upon the expenditure ranking for grant are desirable." [54] The new RDG therefore incorporates a complicated provision which relates the trend in expenditure of any particular authority to the trend in expenditure for the class of authorities to which it belongs.[55] The effect of this is to allow an authority whose expenditure per head of weighted population is below the average to increase its expenditure up to the average and still have this expenditure qualify for RDG. If, on the other hand, its expenditure is above average, then if the expenditure of the group as a whole is rising, the authority will be permitted to qualify for grant to the extent that its own rate of increase accords with that of the group as a whole; but if the expenditure of the group as a whole is falling, then it will be permitted to

[52] The distribution of the percentage of RLE financed by EEG in recent years has been:

For receiving authorities only	1955–6		1956–7		1957–8	
England and Wales ..	24.37%		23.74%		23.88%	
Administrative counties	27.73		27.03		26.61	
County boroughs .	16.01		16.88		18.03	
Size of per cent RLE financed by EEG	A.C.	C.B.	A.C.	C.B.	A.C.	C.B.
60–69.9 per cent	2	..	1	..	1	..
50–59.9 " "	6	1	2	1	2	1
40–49.9 " "	8	..	10	1	10	1
30–39.9 " "	16	8	14	11	12	10
20–29.9 " "	12	11	12	20	14	24
10–19.9 " "	6	18	9	12	9	9
Over 0– 9.9 " "	4	17	5	12	5	11
Total receivers ...	54	55	53	57	53	56
Non-receivers (not included in averages above)	7	28	8	26	8	27

Source: Ministry of Housing and Local Government, Finance Division, Statements B.I. 1419(a) and 1481(a). A.C. refers to administrative counties; C.B. refers to county boroughs.

[53] *The Report of the Committee Appointed to Investigate the Operation of the Exchequer Equalisation Grant in England and Wales* (London: H.M.S.O., 1953).

[54] *Ibid.*, p. 41.

[55] The details of the provision are as follows:

Let x_1, x_2, and x_3 be the actual expenditures per head of weighted population for a particular authority in the years 1, 2, and 3 respectively.

Let X_1, X_2, X_3, and X_4 be the average expenditure per head of weighted population for the class of authorities to which the above authority belongs for the years 1, 2, 3, and 4 respectively.

Let p_4 be the weighted population of the particular authority in the year 4.

Then if $\left(\frac{x_1+x_2+x_3}{3}\right)$ is less than $\left(\frac{X_1+X_2+X_3}{3}\right)$, " normal expenditure "—the maximum amount of RLE that will qualify for RDG—is

$$p_4\left(\frac{X_1+X_2+X_3}{3}\right).$$

But if the above inequality is reversed, then there are two separate cases to be distinguished:

(i) if X_4 is greater than $\left(\frac{X_1+X_2+X_3}{3}\right)$, then normal expenditure is $\frac{X_4}{\left(\frac{X_1+X_2+X_3}{3}\right)}$ *times* $p_4\left(\frac{x_1+x_2+x_3}{3}\right)$,

(ii) while if the inequality in (i) is reversed, then normal expenditure is $p_4\left(\frac{x_1+x_2+x_3}{3}\right)$.

TABLE XI

RATEABLE VALUES PER HEAD OF POPULATION

Local authority averages	1955–6	1956–7	1957–8
England and Wales—Actual	£ 6.628	£11.725	£10.858
Adjusted [a] ...	6.674	11.809	11.057
London	15.015	27.696	24.322
(61) Administrative counties ..	5.660	10.055	9.503
(83) County boroughs	6.607	11.388	10.504

Size of rateable value per head	Number of local authorities					
	A.C.	C.B.	A.C.	C.B.	A.C.	C.B.
£22.000 to £23.999	..	..	..	1	..	..
20.000 to 21.999	..	..	..	2	..	1
18.000 to 19.999	..	..	..	1	..	2
16.000 to 17.999	..	..	..	3	..	2
14.000 to 15.999	..	1	4	7	3	4
12.000 to 13.999	..	1	2	11	1	8
10.000 to 11.999	..	4	13	19	8	21
8.000 to 9.999	4	7	20	29	19	31
6.000 to 7.999	7	30	20	9	25	13
4.000 to 5.999	35	39	2	1	5	1
2.000 to 3.999	15	1	..	..	..	..
Median	£4.718	£6.015	£ 8.520	£10.304	£8.064	£ 9.613
Upper quartile	5.643	7.217	10.317	12.475	9.774	11.490
Lower quartile	4.038	5.471	7.412	8.815	7.005	8.288
$\frac{\text{Upper quartile} - \text{Lower quartile}}{\text{Median}}$	0.340	0.290	0.341	0.355	0.343	0.333

[a] The Minister has power to adjust the national average and to take this figure as the basis of EEG calculations.

Source: Ministry of Housing and Local Government, Finance Division, Statements *B.I. 1478 and 1481(a)*. A.C. stands for administrative counties; C.B. for county boroughs.

maintain its own past average.[56]

The subtlety of this provision cannot but evoke admiration for the ingenuity of its inventors. It leaves below average spenders virtually unaffected, and keeps the others firmly in line. As the White Paper puts it:

> The effect will be that in considering a new project or an expansion of a service there can be no assurance that the increased cost will attract rate deficiency grant; and so far as this grant is concerned each new project will have to be considered on the basis that the whole cost might fall on the rates.[57]

The one loophole that local authorities have is to collude with other authorities of the same class, to ensure that the pace of expansion is fairly uniform. It will be interesting to see whether this does engender a renewed spirit of fellowship and cooperation among " receivers."

Criticisms of the Rate Deficiency Grant

The limitation clause has been criticised on two main grounds: firstly, that it is an unnecessary complication; and, secondly, that it will in fact prove harmful. The first contention rests upon the fact that under the EEG and the RDG the direct connection between high levels of expenditure per head and high

[56] During the first year of operation of the RDG, only one-fifth of " excess " expenditure is to be disallowed, in the second two-fifths, and so on until in the fifth year the whole excess is disqualified.

[57] Cmnd. 209, p. 12.

rate poundages remains, and it is argued that this in itself is a sufficient guarantee against " extravagance." [58]

The second criticism flows from the fact that there is no reason to suppose that unavoidable costs will rise at the same rate in all authorities, or that all authorities will need to expand their services at the same rate or at the same time.[59] Moreover, RDG will be paid on expenditure after the general grant has been deducted. We have seen that percentage grants reduce the difference between high and low costs. To the extent that the general grant does not do this—and in education in particular it is difficult to see how it can—some authorities will be left with unduly high expenditure. Now it is part of the limiting scheme that authorities with expenditure below the average shall be allowed to increase their expenditure, without penalty, at a faster rate than those with expenditure on or above the average. Thus some authorities will be penalized twice by the general grant taking inadequate account of their needs and leaving them with unduly high expenditure to finance from rates now, and then by RDG forbidding them to increase expenditure at an above-average rate unless they finance more of their expenditure from rates in the future.[60] This point is well taken, and forces us to conclude, with Lees, that

> The element of consistency in the limiting device in the present context is that it will cause R.D.G. to work in much the same way as the new general grant.[61]

[58] Thus whether EEG weakens the incentive to local autonomy or not depends entirely on the significance of relatively high rate poundages. If local councils are keenly mindful of the relation between their own rate poundage and those of other authorities, then the EEG contains its own automatic assurance of economical spending. . . . If on the other hand local councils consider the rate cost per head of population, that is the rate bill rather than the rate poundage, then EEG is a positive inducement to excessive spending. (Lees, et al., *op. cit.*, p. 34.)

Lees and his collaborators were convinced that it was the rate poundage that was the crucial factor, and therefore concluded that limiting devices were " superfluous, if not distinctly harmful." (*Ibid.*, p. 35.)

[59] For instance, D. S. Lees writes, on p. 184 of " Reform of Local Finance," *Local Government Finance*, Vol. LXI (August 1957):

> It is certain that the limiting device will deal with some authorities in an arbitrary way. All authorities do not require—or wish—to expand at the same rate, and the costs of expansion will be higher in some areas than in others. Some indication of this is given by the fact that between 1949-50 and 1952-53 the rate of increase of expenditure per head in county boroughs varied between 7 per ment and 51 per cent. The effect of the limiting device is to turn the R.D.G. into a kind of unit grant through time, based on a simple average of expenditure, and this average cannot and will not take account of the profound diversity of local conditions and policies. It will penalize in particular authorities with high costs and those with progressive ideas about local development.

Part of this criticism is obviously ill-founded. The average which is the reference point in the limiting device *does* take into account the " profound diversity of local conditions " insofar as these have already made themselves felt in high levels of expenditure in the past. It does *not*, therefore, " penalise in particular authorities with high cost," but only authorities whose costs *henceforth rise* at a rate above the average of their group. There is no special reason for assuming that these will necessarily be the " high-cost " authorities.

[60] *Loc. cit.*

[61] *Loc. cit.*

Earlier we concluded that the shift from specific, percentage grants towards a general, fixed grant implied a shift in emphasis from flexibility to efficiency, and it is clear that the same sort of shift is in evidence here.

The "Double Compensation" Analysis

We must now turn to the "double-compensation" anomaly, which persists in the new scheme, in spite of the fact that there is no dearth of straightforward adjustments to the grant formula which could easily be incorporated so as to remove it. It is hard to understand why some change has not been made. It does not seem to involve the abandonment of any of the important principles underlying the present grant structure, whether it is desired to retain the present dual system of equalization, or whether it is felt desirable to separate the equalization process into two parts on a different basis, namely to have one resources grant and leave the other grants to deal with needs only.

Changes such as this do not, of course, meet the main objection which is raised against the EEG and RDG, namely that they rest much too heavily on rateable values, the imperfections of which as a measure of wealth do not require further elaboration here. Nonetheless, it is difficult to conceive of an improvement on this so long as rates remain the sole local tax.

Conclusions

Before drawing any conclusions concerning the appropriateness or otherwise of these various equalizing devices, it is necessary to consider explicitly just what sort of equalization is in fact being sought.[62] Is it between ratepayers or between authorities? What is to be equalized? Rate bills per head? Rate poundages? Rateable value per head? Rate yield per head? Expenditure per head? Standards of service? Or what?

It seems to me that, *given* the structure of local-government finance within which equalization devices have to work, the brand of equalization that has the most to commend it is one that ensures that occupiers of similar properties pay the same amount in rates for any given

TABLE XII

RATES AS A PERCENTAGE OF TOTAL FAMILY EXPENDITURE BY REGIONS IN 1937

Type of household	London	S.E.	S.W.	Midlands	N.E.	N.W.	N.	Wales
All households	4.1%	3.0%	2.9%	2.9%	3.5%	3.4%	3.5%	4.0%
Agricultural	1.9		1.5			1.7		2.2
Industrial	4.1	3.2	3.1	3.1	3.7	3.6	3.7	4.1
Industrial households in towns with populations of:								
Under 50,000	..	3.0	2.9	2.9	3.3	3.0	3.7	4.1
50,000–99,999	..	3.6	2.8	3.4	3.9	3.5	3.2	4.7
100,000–249,999	..	4.3	3.8	3.4	2.5	3.7	4.1	4.6
250,000–499,999	..	..	3.4	3.8	4.2	..	3.7	..
500,000 and over	4.1	..	..	3.1	4.2	4.5	..	..

Source: J. R. and U. K. Hicks, *The Incidence of Local Rates in Great Britain*, Tables 2A (p. 12), 2B (p. 13), 3 (p. 19) and 4 (pp. 24–5).

[62] For a fuller discussion of the issues raised here, and their implications, see *Accounting Research*, Vol. II (July, 1951), pp. 2-10.

"package" of local services. Now *if* valuations were uniform, *if* all services were provided at minimum cost, *if* these costs did not vary per unit of service from one authority to another, and *if* the anomalies within the grant structure were removed, *then* this would mean designing a grant which made rate poundages proportional to local expenditures per head. This is more or less what the EEG and RDG in fact do *for those authorities receiving them.* Although the underlying assumptions are, to say the least, heroic, we can accept them for the time being as a working hypothesis. Then the way to achieve the sort of equalization that appears to be the objective of policy would be to rely on one comprehensive resource-equalizing grant covering all authorities, based on per capita rateable values or rate products, leaving it to the other grants in the system to take account of varying needs, including, of course, those due to cost differentials.

5. *Borrowing and Capital Expenditure*

The gross fixed-capital formation of local authorities has, in the postwar period, constituted a substantial part of their total demand for real resources, as can be seen from the following figures (see also Tables II and V, Part I):

	Local-authorities expenditure on goods and services (In millions)									
	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957
Current expenditure on goods and services	£529	£541	£564	£628	£687	£732	£783	£841	£951	£1060
Gross capital formation	372	383	406	460	540	608	577	543	572	585

In Part I, pages 306-311, and Tables VI and VI A the salient features of these capital transactions have already been outlined. It is to this aspect of local-government finance that we shall now devote some attention.

The first thing to be appreciated is that local authorities have had much less autonomy in the field of capital expenditure than in the field of current expenditure. In the first place, they have been subject to the same licensing and controls that were imposed on other sectors of the economy in the early postwar years. Secondly, and much more important for our purposes, local authorities are required to obtain the prior approval of the central government before borrowing. Thirdly, the central government can (and does) regulate the way in which such loans are raised. Fourthly, for certain grant-aided services the government controls the capital expenditure itself. In what follows we shall first consider the direct control of capital expenditure, then the use of the loan-sanction procedure, and finally control over access to the capital market. General licensing of raw materials and control over labour supplies will be ignored as an emergency measure not specifically related to central-local-government relations.

Direct control of capital expenditure. Direct control over capital expenditure for grant-aided services is usually exercised by requiring the submission to the appropriate Ministry of annual programs, which will then be approved as ranking for grant, supported as eligible for loan sanction, or reserved for fur-

ther consideration. There have also been attempts to exercise control by requiring long-term programs to be submitted as well, the object being to enable the nation's resources to be allocated more sensibly by a careful selection and timing of public-investment projects. Such long-term forecasts were requested particularly in the immediate postwar years, and the forecasters were asked to approach the task with "thorough realism taking account of the marked excess of demand over supply which should be assumed to continue throughout the period covered by the estimates."[63] This plea was in vain, however, and the grossly over-optimistic plans that were submitted rendered the exercise largely useless. In 1954 a rather more cautious request was made asking for the submission of any investment projects costing more than £50,000 each which could be started in the then-existing conditions within the following six or seven years. This investment survey seems to have served its purposes better than the earlier ones, but whether this is due to a more chastened response or to reduced stringency in the economy generally it is difficult to say.

Loan-sanction procedure. Much more important than this, however, is the power wielded by the central government through the loan-sanction requirement. This power has, in fact, much wider ramifications than appear at first sight.

> The need to secure approval of loans offers a good opportunity for the Minister . . . to ask the Local Authority to do something . . . in return. . . . The Ministry has made use of this power on occasion to keep a check on the general financial position of the Local Authority. . . . In . . . (one) . . . case . . . the Minister of Health refused to sanction a loan by way of overdraft at the bank unless further measures of economy were undertaken by the Council. . . . Loan sanction has also sometimes been withheld from the provision of independent sewage schemes with a view to persuading the Local Authority to make use of the facilities of a neighbouring large Local Authority or to arranging some other form of joint scheme. Finally, there is the general use of this power to secure that the buildings or other public works which the loan represents are in keeping with the ideas of the Department concerned. . . . A Local Authority may, for example, apply for sanction for a loan to build a new town hall. The application gives the Minister . . . power to examine the plans of the proposed building, to keep a watchful eye on the contracts involved and, if necessary, refuse to sanction the loan unless the plans are modified, possibly in the direction of reducing the costly ornateness of the building. But the application also gives the Ministry the opportunity to exert a more positive power in that it can refuse to sanction the town-hall loan on the grounds that the Local Authority could better spend the money on (say) a new sewage scheme. A negative or sanctioning weapon may thus be used to achieve something the Ministry considers to be more necessary.[64]

The loan sanction has its limitations too, of course. The refusal of loan sanction for one project may not induce the authority in question to apply for a loan for something else that the central government thinks should be given priority. Moreover, even if the local authority does prove amenable on this point, it may nevertheless prove willing and able to finance the original project out of its own resources. Much capital expenditure is, in any case, financed out

[63] Ministry of Health, Circular Number 9, 1947.

[64] Chester, *op. cit.*, pp. 102-3.

TABLE XIII

RATE POUNDAGES

Average rate poundage of local authorities	1947–8	1955–6	1956–7	1957–8
England and Wales	17s. 10d.	22s. 10d.	15s. 8d.	18s. 0d.
London	14s. 5d.	19s. 7d.	12s. 8d.	15s. 11d.
(61) Administrative counties	18s. 6d.	23s. 4d.	16s. 2d.	18s. 0d.
(83) County boroughs	18s. 6d.	23s. 6d.	16s. 5d.	19s. 0d.
Size of rate poundage				
Administrative counties:				
28s. to 29s. 11d.	..	5	..	..
26s. to 27s. 11d.	2	12	..	..
24s. to 25s. 11d.	2	22	..	..
22s. to 23s. 11d.	5	17	..	4
20s. to 21s. 11d.	13	4	2	11
18s. to 19s. 11d.	21	1	14	30
16s. to 17s. 11d.	14	..	31	12
14s. to 15s. 11d.	4	..	11	4
12s. to 13s. 11d.	..	..	3	..
Median	19s. 1d.	24s. 4d.	16s. 10d.	18s. 8d.
Upper quartile	21s. 2d.	26s. 1d.	18s. 0d.	19s. 7d.
Lower quartile	17s. 9d.	23s. 8d.	16s. 0d.	17s. 11d.
$\frac{\text{Upper quartile} - \text{Lower quartile}}{\text{Median}}$	0.179	0.099	0.119	0.089
County boroughs:				
30s. to 31s. 11d.	1	1	..	..
28s. to 29s. 11d.	..	1	..	..
26s. to 27s. 11d.	..	16	..	..
24s. to 25s. 11d.	3	21	..	1
22s. to 23s. 11d.	9	21	..	7
20s. to 21s. 11d.	14	14	2	24
18s. to 19s. 11d.	21	4	28	25
16s. to 17s. 11d.	22	3	29	16
14s. to 15s. 11d.	7	2	15	6
12s. to 13s. 11d.	4	..	7	4
10s. to 11s. 11d.	2	..	2	..
Median	18s. 6d.	23s. 6d.	16s. 8d.	19s. 6d.
Upper quartile	20s. 3d.	25s. 7d.	18s. 3d.	20s. 6d.
Lower quartile	16s. 6d.	21s. 6d.	15s. 3d.	16s. 11d.
$\frac{\text{Upper quartile} - \text{Lower quartile}}{\text{Median}}$	0.203	0.174	0.180	0.184

Source: Ministry of Housing and Local Government, *Return of Rates and Rateable Values, England and Wales*, 1947–8, 1955–6, 1956–7, 1957–8.

of current revenue, and indeed much of it qualifies for direct grant-aid from the central government, either wittingly or unwittingly.

Some ministries, perhaps unintentionally, encourage the practice of meeting capital expenditure from revenue. The Ministry of Transport admits road improvements for percentage grant in the same way as road maintenance, and the Home Office follows a similar course in relation to civil defence capital expenditure irrespective of how the local authority finances its share.

Other ministries, however, exercise control over the amount of capital expenditure that may be met from revenue by grant-aided services . . . .

Perhaps the most important form of

control . . . is the disallowance for grant purposes of capital expenditure from revenue over a certain limit. This method is exercised at present in relation to local health and education. The Ministry of Health disallows capital expenditure exceeding £2,000 for the purchase of land or buildings or £10,000 for other items, or exceeding the product of a penny rate, unless the expenditure has been approved by the Minister. The Ministry of Education limitation applies to main grant services only and, until 31st March, 1956, was, in effect, the amount of capital expenditure met by the authority from revenue in 1948-49 or the product of a penny rate, whichever was the greater. Any excess was not allowed to rank for grant.[65]

Besides these controls over particular services, there is also " a general control exercised by the Ministry of Housing and Local Government over all authorities in receipt of Exchequer Equalisation Grant. The Minister can make such adjustments to that grant *as appear to him necessary* to correct abnormal treatment of capital expenditure charged to revenue in the accounts of the authority." [66] There was, however, no evidence that this power had ever been used, not even against one high-grant county which was meeting all its capital expenditure from revenue as far as the particular controls mentioned earlier would allow. Nor is there any evidence that high-grant receivers tend to charge more capital expenditure to revenue than other authorities do.

The loan sanction is therefore likely to be most powerful in the case of poor but ambitious authorities, for " stinting " authorities do not engage in much capital expenditure in the first place, and in the richer authorities there is much more scope for charging capital expenditure against revenue, either directly or via capital funds. Before 1953 the power to set up capital funds could only be obtained by special Act of Parliament, but under the Local Government (Miscellaneous Provisions) Act of that year general provision was made for the creation of such funds. The total amount which may be in the fund at any time is usually limited to the product of a one-shilling rate. There are also limitations on the amount that can be allocated from such funds to any one project, and no such funds can be used to finance capital outlays on education or on trading services. But as one County Treasurer has observed:

> Moneys out on loan . . . do not have to be counted as part of the balance of the capital fund, and, if, at any time, the annual income of the fund from rate contributions and repayments with interest shows signs of exceeding the statutory limit on the balance of the fund, the repayments can be made at . . . shorter intervals and re-applied immediately in meeting capital expenditure so that the limit is never reached.[67]

Moreover, " [w]here grant-aided services are concerned it is important that . . . notional loan charges . . . be charged against the . . . service and . . . thus rank for grant." [68]

Capital-market access. Besides the loan-sanction device itself, however, there is also the further question of the way in which the money is to be borrowed, i.e., the source of the funds and the terms of the loan. Here the policy of the central government has changed

[65] N. Doodson, *et al., Local Authority Borrowing* (London: Institute of Municipal Treasurers and Accountants, 1957), pp. 31-2.

[66] *Ibid.*, p. 33.

[67] Presidential Address by W. O. Atkinson to the 1958 Annual Conference of the Institute of Municipal Treasurers and Accountants.

[68] *Loc. cit.*

drastically in recent years. Two aspects of the matter deserve special consideration—subsidies (on housing) and the operations of the Public Works Loan Board.

There are many sorts of housing subsidy—for slum clearance, rural housing, flats on expensive sites, etc.—but we shall here be concerned only with the general-needs subsidy for new housing. The original purpose of this subsidy was to enable local authorities to provide housing of a reasonable standard at rents which fell within the means of working-class families. One of the major elements in calculating the " market rent " is, of course, the interest payment on the money that has to be borrowed to finance the construction of the house. The rate of subsidy has, until recently, tended to adjust in a rough-and-ready way to changes in the level of interest rates. In the postwar period the subsidy has been paid by the central government at an agreed annual rate to which it is committed for 60 years. The local authority has been required in addition to provide from its own resources one-third of the amount put up by the central government. By the Housing Subsidies Act of 1956, however, the general-needs subsidy has been substantially reduced as a first stage towards its abolition, but the special subsidies remain. The main reasons for this change have been the dislike of the long-term commitments involved for the Exchequer, the easing of the postwar housing shortage, a general attempt to restore the influence of the market to housing, and the fact that the subsidy was no longer clearly helping the " poor " and the expense of the " rich." From the present viewpoint, however, housing subsidies are best regarded as a device for reducing the effective rate of interest payable on loans raised to finance local-authority housing construction. Viewed in this light they are best considered in conjunction with the activities of the Public Works Loan Board, to which we now turn.

The Public Works Loan Board is a governmental agency which has provided finance for the investment projects of local authorities on the same sort of terms as those on which the central government itself is able to raise money. During the early part of the postwar period local authorities were, in general, forced to raise any external funds they required from this source, although, as we shall see, this was really no hardship. From 1953 until 1955 this restriction was relaxed, and borrowing from the PWLB became optional, and, if local authorities so desired, they could go to the market directly for any loans that had been sanctioned. With the advent of the government's restrictive credit policy, however, borrowing from the PWLB became very much more attractive, and in October 1955 local authorities were denied access to the PWLB unless they could show that they could not raise the funds that they wanted from the open market. It was this policy switch that caused the violent fluctuations in the sources of local-authority capital funds noted earlier in Table VI and page 111 of Part I.

The course of developments during this period was well summed up by Roland Bird.

> For seven years up to the end of 1952 local councils were in general prohibited from borrowing except from the Board (though they could borrow elsewhere in circumstances approved by the Treasury). There were occasions during that period when it was positively profitable for local authorities to borrow from the Board

and to re-invest the funds so raised in short-dated bonds until their capital commitments became due. Moreover, local authorities then were able to get from the Board its automatic consent to their borrowing, coupled with its assurance that the money would be held ready for them when they called for it. So, armed with the departmental consent to the particular scheme for which finance was sought, the authority could obtain with the minimum trouble a firmly underwritten loan from the Board. But it was under no compulsion to take the loan up; without infringing the general prohibition on borrowing outside, many authorities were able to raise finance from outside sources.

For each of the three years to March, 1952, the difference between loans that the Board had approved and loans that it actually advanced was not far short of £100 millions. Two years later the Board's outstanding but unexercised commitments had reached the formidable total of £650 millions. There were good reasons why local authorities occasionally preferred to borrow from other sources. Some of them disliked having to make an immediate start on the repayment of principal which the Board insists on. Others, in periods of firm interest rates, did not relish the rule (as it then stood) that a PWLB loan must be for the same term as the period for which the departmental consent was given; if they could borrow from outside sources for a shorter term, they calculated, it might be possible to re-finance the loan at a more favourable rate for the remainder of the consent period. It is not too rude to say, however, that the local authorities had come to regard the Board's facilities as a convenient soft option, to be taken up if circumstances favoured such a course, and to be left unused (save as a safe foundation for bargaining with the market) if they did not.

A radical tidying up was needed. At the end of 1954 the rule was introduced by which local authorities should apply to the Board for loan approval . . . only if it were reasonably certain that they would wish to raise the money from the Board. At the same time the Treasury informed the local authorities that all loan approvals given by the Board before the end of 1952 and still unexercised would be cancelled; this resulted in the elimination of more than £150 millions of approvals from the Board's books.[69]

Local authorities are now forced to compete with industry for funds on the open market on much more equal terms.[70] Because this new régime has coincided in the main with a period of increased credit stringency, however, the effect has been to force local authorities to rely to an increasing extent upon internal sources of finance. One suspects that revaluation, and the enlarging of the tax base which it entailed, was seized upon as an opportunity of doing this. Nevertheless, it is clear that local authorities are having to run the gauntlet of the market far more than at any other time in the postwar period, and there is no doubt that it is the policy of the central government that this should be so.

The merits or otherwise of this policy are not our main concern here, but in conclusion it may be worthwhile to consider one proposal that has been made recently concerning the future policy and functions of the PWLB. J. R. Sargent writes:

> The suggestion that a common test should be imposed upon public and private investment by enforcing the use of the capital market does not imply that the capital market should be the final authority for selecting the investment that

69 "The Finance of Local Government," *Lloyds Bank Review*, January 1956.

70 One recent measure that works the other way however, was the decision to allow trustees to invest their funds in local-authority mortgage loans.

> is actually to be done. . . . What is required is that . . . there should also be some body responsible for remedying imperfections in the market's judgment. Here, I would suggest, is the proper part to be played by a Public Works Loan Board, having access to government funds and power to use them to supplement the supply of capital through the market. The Board should act as a lender of last resort, as it now does to Local Authorities; but with two differences. First, it should not be as passive in its performance as the phrase 'lender of last resort' suggests; but should actively keep the investment programme under review, equipping itself to study the contributions made to national output by different projects and identifying cases where it might on its own initiative step in to finance projects which will justify themselves on economic, but not on financial, grounds. And secondly, the Board should have power to lend, not merely to Local Authorities, but to Public Corporations and to the private sector . . . for . . . it is important to realise that this excess of economic over financial return, although probably more marked in the field of public investment, cannot be regarded as confined to it; hence the necessity to extend to private investment the possibility of assistance from the Public Works Loan Board.[71]

All that I need add to this is that such a change would be rendered much more effective if, simultaneously, some way were devised of forcing internally generated capital funds out onto the market as well, in both the public and private sectors.

IV. CONCLUSIONS

The fundamental problem of local-government finance is how resources shall be placed at the disposal of local authorities in such a way that they are able to fulfill adequately the functions which both the local and national electorate demand of them, without sacrificing to an intolerable degree the concomitant demands for equity and efficiency. Local authorities have three chief methods of acquiring command over resources: by levying local taxes, by sharing in national taxes via grants-in-aid, or by borrowing (directly or via the central government or its agencies). We have seen that during the decade under review the central government has controlled, in varying ways and to differing degrees, each of these means of financing local government. Local authorities are permitted to use only one tax, the local rate, and its base is virtually determined by the central government, leaving local authorities simply with the decision as to what the level of tax shall be. The form and scope of grants-in-aid are also set by the central government, though with some types of grant the amount payable is in fact to a large extent determined by the local authority. The capital expenditure of local authorities is also restricted in most of the important fields, and local-authorities' independence is slight when it comes to borrowing. Hence, understandably, the oft-repeated complaint that, despite protestations to the contrary, the central government is rapidly turning local authorities into regional offices of the central government. It is futile to deny that a great deal of local autonomy has been sacrificed in recent years, but, as was pointed out in the first part of this paper, this has not been done without reason. It is not just a matter of paying lip-service to local autonomy and then putting it at the back of one's mind, but rather a matter of realizing that local autonomy is only one among many desirable fea-

71 "The Relationship of the Capital Expenditure of Local and Public Authorities to the Capital Investment Programmes," Institute of Municipal Treasurers and Accountants, 1957.

tures of central-local-government relations. Local autonomy means the power to act in accordance with local interests, and I have already argued that this power must be subordinated, in a unitary state, to the duty to act in accordance with national interests.

Is it then plausible to interpret the national interest as requiring the type of measures that have been carried out in this field in the last decade? I think that it is, in general. In the case of local rates, the central government clearly considers them to be an integral part of the national tax structure, the proceeds of which are allocated on the basis of origin. Once one adopts this view, then equal treatment of equals requires standardization of the tax base, and a tax rate roughly geared to the services received in exchange (unless the tax in question is to be used deliberately in a redistributive sense, which, with the exception noted below, does not seem to be the case with local rates). This is the direction in which the local rate is going, though it would be idle to pretend that it fits this description perfectly. The exception is that the central government considers this property tax a suitable vehicle for subsidizing particular sectors of the economy. Although one may quarrel with this as too roundabout and capricious a technique for this purpose, once local rates are viewed as part of the national tax structure one cannot go beyond this. Both the standardization of the rate base and the granting of certain exemptions through derating have important consequences for the grant system, of course, and this makes it difficult to assess all the repercussions of these measures. It is certain however that their main impact is upon equalization grants and devices.

The grant system in general has been used in a discriminatory way both between authorities and between services. The justification for this, and for the coercive powers often attached to grants, and often, too, wielded independently of them, is not hard to find. Both a uniform minimum standard of service and reduced disparities above this minimum have been strongly held political objectives in virtually all social services in postwar Britain. The use of the grant structure to assist in its achievement seems a natural outcome, and one which, to me at least, is quite acceptable.

Finally, when it comes to capital expenditure and local-authority borrowing, the importance of local government in the economy as a whole in this type of activity is such that the central government would virtually be abandoning its responsibility to maintain a fairly stable, growing economy at a high level of activity if it were to leave local authorities free to behave as they wished in this field.

The Majority View

This view is not shared by the majority of writers on local-government finance, however. Consider, for instance, the following eloquent plea for greater local autonomy:

> In our view the main drawbacks of centralization are the loss of interest of the electorate in local affairs, a consequent decline in the enthusiasm of members of . . . councils, and the unwillingness of men and women of sufficient calibre to come forward as local government candidates. . . .
>
> There are those who honestly believe that modern conditions demand centralization and who would welcome not merely the decline but the elimination of

local government. We do not share this view. The claims of totalitarian states to greater efficiency than democratic states are, we believe, unfounded, especially if long term trends and the larger issues are considered. . . . As a result of our own study of local government, we believe that men wish to feel that they have some say in their own affairs and prefer freedom to make mistakes rather than be ruled by bureaucrats, however wise and benevolent. We believe that this freedom is as important as the low cost and high quality of the services offered, and, with certain exceptions, standardisation of practice is not in itself of such importance as to justify the elimination of local interest.[72]

My only additional comment on this would be to express doubt as to whether it is proper to assume that local authorities are, in fact, more "democratic" (or even less bureaucratic) than the central government. It is clear, however, where such views lead in the field of local-government finance. As an example, we may this time take the Royal Institute of Public Administration, which

> . . . expresses growing concern with the trend of local government finance in Great Britain. Local authorities have come to receive a progressively smaller proportion of their income from revenues under their own control, such as rates, and a correspondingly larger proportion from central government grants. . . . Increased financial aid from the central government leads to greater administrative control from the centre, with the result that local autonomy is reduced and the responsibility of local authorities to their electorate diminished. . . .[73]

[72] West Midland Group, *op. cit.*, p. 5.

[73] Royal Institute of Public Administration, *op. cit.*, p. 7.

In a guarded way, the government ostensibly went some way to meet this view in its latest White Paper on Local Government Finance.

> A main aim of the proposed changes has been to increase the independence of local authorities in the raising and spending of their money so far as it is practicable to do so. Since the First Report of the Local Government Manpower Committee in December 1949 [Cmd 7870] it has been a declared objective of Governments to simplify and reduce Departmental Control, on the view that "local authorities are responsible bodies competent to discharge their own functions and . . . they exercise their responsibilities in their own right. . . . It follows that the objective should be to leave as much as possible of the detailed management of a scheme or service to the local authority and to concentrate the Department's control at the key points where it can most effectively discharge its responsibilities for Government policy and financial administration." [74]

But it seems to me that there is nothing to be gained by trying to slur over that fact that in many important respects there is bound to be a conflict between local autonomy and national policy. Here I find myself in complete disagreement with D. N. Chester, for instance, when he writes:

> . . . in practice there will never be a *great* divergence between the *general* policy of the Government and the opinions expressed by the *generality* of Local Authorities. There may be time-lags, there may be differences which creep in owing to the different mechanics of actually registering electoral opinion. . . . There will, of course, be differences of opinion on the administration of and finance of any policy and these differences may affect the harmony of the two sets of demo-

[74] *Cmnd.* 209, p. 4.

> cratic institutions but the *basic* agreement should be there. It is therefore unreal to refer to central-local relations as *though* a Government Department may have to coerce Local Authorities representing the great majority of the electorate. Should there be a head-on clash between a Department and the *mass* of Local Authorities on any *general* issue the Minister may be misinterpreting public opinion or the fault may be on the side of the Local Authorities. But it cannot be assumed that the Minister must necessarily be right. *In the long run it is axiomatic that the two sets of views must be in broad agreement.*[75]

and this in spite of the fact that " a number of Local Authorities . . . may not be in agreement with the *whole* of the Government's declared policy." [76]

Not even the careful stress laid on *broad* generalities and *massive* conflicts in all the major propositions, which Chester asserts, can conceal the fact that the " escape clauses " in between provide ample scope for major deviations from the postulated " consensus of opinion as to the manner in which a particular service should be provided or a particular function administered." [77] Moreover, we may not be willing to wait patiently for the " long run " in which Time, the Great Healer, eventually restores harmony, even if we have faith in her ability to do so. Assuming, however, that we can brace ourselves to accept these deviations stoically, as part of the pain associated with a healthily democratic body politic, then it still seems to me that Chester is fundamentally wrong. Local councils are elected to promote local interests by people presumably concerned with local interests, whereas Parliament is elected to promote the national interest by people presumably concerned with the national interest. Chester's assumption, that this is " the same Milieu of Public Opinion " [78] just because more or less the same people are involved in each electoral process, seems to me to be quite untenable. For example, I may well vote in national elections for a policy of price stabilization, and at the same time vote in local elections for an expanded programme of housing construction in my own local authority, knowing full well that the two may be incompatible. But I am, if necessary, willing to have my own local authority coerced into restricting the scope of the programme I have voted for, provided that other local authorities are similarly treated! Although the setting is slightly different, this is still essentially the classic problem of public finance—how to get collective wants expressed and satisfied within a basically individualistic political and economic framework.

As was mentioned at the outset,[79] this is not to deny that local autonomy is desirable, and I would agree with the general tenor of C. H. Wilson's argument (though not all of his assertions) when he writes:

> . . . local representative institutions are designed to meet the fundamental requirements of participation, discussion and education. They do provide, on the largest scale, an opportunity for the citizens to share in public decisions and administration, they do provide the machinery of discussion and vote to elicit consent, they do provide, in the only possible way, for the political education of the people. It is their additional merit that they also serve the administrative purposes of cen-

[75] *Central and Local Government*, pp. 8-9, italics supplied.

[76] *Loc. cit.*

[77] *Op. cit.*, p. 13.

[78] *Op. cit.*, p. 7.

[79] Part I, p. 305.

tral government as channels of local intelligence and agents of local executive action.[80]

Local representative institutions do not function in a vacuum, but as parts of a society which makes decisions about national interests through processes of participation, discussion and education which correspond to those just mentioned, but which in this case are focussed upon the central government. As W. S. Steer has said:

> . . . [P]eople who plead for local freedom, if by that they mean freedom to determine the content and standards of the personal social services, are closing their eyes to political realities. . . .
>
> I suggest that the time has come when instead of basing the finance of local government on the illusion that all local authorities do is local self-government, . . . we ought to recognise that over large areas of local authority work national interests must override local considerations and marked local variations of standards and methods cannot be tolerated. . . .
>
> When acting in matters of purely local concern, it is right and proper that the authority should decide for itself both what is to be done, and how and by whom it is to be done. As a necessary corollary it should expect to have to pay the whole cost of these activities from its own resources. When, however, the local authority is acting virtually as an administrative agent for a central department there is no justification for requiring local councils to raise large sums of money for such services from local residents. For how can local councillors be held responsible to a local electorate for expenditure on services over which the council has no real control?
>
> For the mixed services, in which national and local interests are combined, it would seem to follow that the proportion to be borne by rates and taxes respectively should reflect the proportions in which local and national control is shared.[81]

The adoption of this principle would probably lead to results precisely opposite to those desired by most reformers of local-government finance. Steer envisages that the " transfer to the state of the cost of national services while not reducing total public expenditure, would bring much needed relief to hard-pressed local authorities." [82] But, since there is no suggestion that local authorities should cease to administer the services in question, this reduced pressure on rates has, as its counterpart, increased reliance on government grants, and hence increased pressure on central-government taxes. What now if the government considers the tax structure as a whole to be its responsibility, as we have seen that it clearly does?

In this case, the central government would itself appear to be justified in entering directly into the field of property taxation, and levying a uniform " national " rate with which to finance the increased grants, rather as the administrative counties do vis-à-vis their constituent authorities. It would in fact be driven to some such measure if it did not wish to change the incidence of the general tax structure. What would then have been achieved would be the substitution of a property tax whose proceeds are shared according to expenditure on centrally controlled services, for a property tax whose proceeds are shared according to authority of origin. Thus unless Steer's idea is not only to bring

80 " The Foundations of Local Government," in C. H. Wilson, ed., *op. cit.*, pp. 20-21.

81 " The Financing of Local Government," *The Political Quarterly*, 1956, pp. 423-433.

82 *Ibid.*, p. 430.

financial and administrative dependence into closer conformity, but also to change the incidence of the tax structure, then it will mean more grants in relation to local revenues, and possibly still more confusion in the minds of the local electorate as to who is taking what share for what purpose!

My own view, therefore, is that although there is much in the present system of financing local government that needs tidying up, there are no sweeping changes that are called for *given* the present structure of local authorities and the general political ideas prevalent in Britain today. The most pressing problem facing local government in England and Wales at the moment is, in my opinion, not one of finance at all, but concerns the structure itself. Until some radical recasting of areas, status, and functions has been achieved, we shall continue to witness periodic tinkerings with the financial arrangements to relieve the strain on the weaker parts of the structure. Such a reform would not, of course, eliminate the financial problem, but it might provide a setting in which it became more tractable.

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INDIAN INCOME, WEALTH AND EXPENDITURE TAXES: INTEGRATION AND ADMINISTRATION [1]

RICHARD M. EIGNER *

I. INTRODUCTION

THE Indian government has been guided by a rather complex set of objectives in formulating recent policy relating to direct taxation. Additional revenue is needed, particularly in connection with the second five-year plan. Widespread evasion of the income tax has been a matter of concern. The nation is in urgent need of capital formation, and the tax system should be designed to foster productive investment. An equalitarian ideal of social justice requires that taxes be levied in accordance with capacity to pay and that they be designed to preclude inordinate accumulations of wealth by a few.

The government has recently made the following additions to the direct tax system: a capital-gains tax (1956), a net wealth tax (1957), an expenditure tax (1957) and a gift tax (1958). The enactment of these measures represents a piecemeal implementation of the recommendations made to the government in 1956 by Nicholas Kaldor of Cambridge University, England.[2] Kaldor recommended that income, net wealth, expenditure, capital-gains, gift, and inheritance taxes be combined in a single comprehensive return. India has now enacted each of the taxes which make up the suggested comprehensive return. There is, however, no provision for a comprehensive return, each of the taxes being reported separately. The new measures and the existing income and estate taxes have nevertheless been thought of as forming a unitary system.[3]

Kaldor's approach to the problem of administration is striking and somewhat paradoxical. The administration in India of a complicated income tax, based on the British model, has proved very difficult.[4] An expenditure tax has usually

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[1] This paper is an outgrowth of the writer's work as a Research Assistant in connection with the preparation of *Taxation in India*, a forthcoming volume of the World Tax Series. The World Tax Series is a continuing project of the Harvard Law School International Program in Taxation. Volumes have already been published on Australia, Brazil, Mexico, and the United Kingdom; the next group of volumes will include Colombia, France, Germany, India, and Sweden. The writer is particularly indebted to Oliver Oldman, Lecturer in International Tax Law at Harvard University, for generous help and valuable suggestions.

[2] Nicholas Kaldor, *Indian Tax Reform, Report of a Survey* (New Delhi: Ministry of Finance, Government of India, 1956). The enacted measures differ considerably from the measures proposed. Kaldor's reaction to the enacted measures appears in *The Economic Weekly* Vol. XI (January 1959) p. 195.

[3] See "Pattern of New Taxation—Social Objectives," address of the then Finance Minister, T. T. Krishnamachari, in the upper house of the Indian Parliament on September 5, 1957; A. C. Minocha, "Wealth Tax and Expenditure Tax," *Indian Review*, Vol. 59 (April 1958), p. 164.

[4] Concern about widespread evasion of the income tax resulted in legislation in 1947 establishing an investigative commission with powers to report generally on the adequacy of the law in preventing evasion and to investigate specific cases referred to it. The commission issued a report discussing the law generally and a later report dealing with specific cases referred to it and was able to recover a substantial amount of unreported income. The commission's authorization was allowed to expire at the end of 1955 partly because of certain constitutional

been considered to be administratively unworkable even for an advanced nation.[5] The other taxes which would be included in the comprehensive return involve administrative problems of their own. Kaldor maintained that the combination of taxing measures would not compound but would instead relieve the administrative problems connected with each separate measure. He argued that the administration of each tax would be made easier and more effective in that the accounts rendered for each tax would operate as a check and verification of the others.[6]

The proposition that the administration of direct taxes can be improved by the enactment of a comprehensive self-checking system is of interest both in the setting of Indian taxation and generally. The self-checking character of the system proposed by Kaldor has two aspects. One aspect relates to the reconciliation of the accounts for different taxes of a single taxpayer. The other aspect relates to a recommended voucher system for capital transactions by means of which transactions reported by one taxpayer would be checked against transactions reported by another taxpayer.

This paper deals with the first aspect, namely, the reconciliation of accounts for different taxes of a single taxpayer. The major items in such a reconciliation would be income, net wealth, and expenditure. The Indian income, net wealth, and expenditure taxes are first briefly described. Possible methods of reconciling income, net wealth, and expenditure are discussed in general terms. The return form suggested by Kaldor is examined. Finally, the reconciliation of the returns under the Indian taxes and the outlook for administration in India are discussed.

II. DESCRIPTIONS OF THE TAXES

The Indian *income tax,* which is modelled on the British tax, is schedular in form but global in principle. The total income of individuals and Hindu undivided families[7] is subject to tax at progressive rates ranging from 3 to 70[8]

difficulties which arose in connection with its powers. A general lack of adequate record keeping has increased administrative difficulties. As a result a high number of assessments are estimates based on evidence other than the taxpayer's books. Large arrearages in assessment and collection are another aspect of the problems connected with effective administration of the income tax. *Report of the Taxation Enquiry Commission, 1953-54,* Vol. II, pp. 189-241 (New Delhi: Ministry of Finance. Government of India, 1955).

[5] See the testimony of A. C. Pigou and J. M. Keynes in 1924 before England's Royal (Colwyn) Commission on National Debt and Taxation. When the United States Treasury Department proposed such a tax to the Senate Finance Committee in 1942 as a contribution to inflation control, it was summarily rejected as unworkable. See Randolph E. Paul, *Taxation in the United States* (Boston: Little, Brown and Company, 1954) p. 312. In 1955 Kaldor proposed an expenditure tax for England in *An Expenditure Tax* (London: George Allen & Unwin, Ltd., 1955). English comment appears to have been generally unfavorable to the workability of the proposal. See, for example, A. M. Prest, "An Expenditure Tax?" *Lloyd's Bank Review* (Oct. 1956) and the references there cited.

[6] With regard to administration Kaldor also maintained that a multiplicity of taxing measures would be beneficial in that it would be unnecessary to have very high marginal rates under any one tax. He also supported a multiplicity of measures on grounds of equity and economic incentives.

[7] A Hindu undivided family consists of all male persons lineally descended from a common ancestor and includes their wives and unmarried daughters. In practice the Hindu undivided family seldom goes beyond three generations. The family property is managed by an acknowledged head, known as the *karta.* Within the joint family is a narrower body, known as the coparcenary, the exact constitution of which depends upon the applicable school of Hindu law. All members of the family may have separate property and income.

[8] These figures are exclusive of surcharges of 5 per cent of the entire tax and 15 per cent of the tax attributable to unearned income.

per cent. Corporations are subject to a special rate structure. Special provisions govern the taxation of partnerships and certain other entities. Capital gains have been taxed since 1956. They are taxed at special rates and subject to certain limitations. Agricultural income is exempted.[9] There are regular provisions for depreciation, and, as an incentive for economic development, there are provisions for additional depreciation and for investment allowances in addition to depreciation (development rebates). There is no provision for depletion or for the recovery of the cost of an annuity. The income from certain transferred assets is included in the income of the transferor. After these adjustments, a married individual with more than one dependent child is subject to tax on income in excess of Rs. 36,000 ($756). The *Report of the Taxation Enquiry Commission 1953-54* states that the total number of assessees of all kinds for the tax year 1952-53 was 900,406.[10]

The *net wealth tax* is an annual tax on the value of all the property owned by the taxpayer on a given date, less his debts. Individuals and Hindu undivided families are taxed at progressive rates, while corporations are taxed at a flat rate. Numerous classes of property are exempt. One of the exempt classes of property is agricultural land.[11] Value is measured by market price, but business assets may and normally will be valued as a whole on the basis of a balance sheet adjusted "as required." Certain assets which have been transferred by an individual revocably or without adequate consideration are included in his tax base. The rate of tax, which is designed to be within the normal annual yield of productive property, is graduated from ½ to 1½ per cent for individuals and Hindu undivided families and is a flat ½ per cent in the case of corporations. There are initial allowances of Rs. 200,000 ($42,000) for individuals, Rs. 400,000 ($84,000) for Hindu undivided families, and Rs. 500,000 ($105,000) for corporations. Special rules grant limited relief from "double taxation" to corporate shareholders. Prior to any experience under the act the number of persons expected to be subject to the wealth tax was estimated as follows: 26,000 individuals, 4,000 Hindu undivided families, 6,000 corporations.[12] Wealth taxes are in effect in Sweden, Norway, Colombia, the Netherlands, West Germany, and other countries.

The *expenditure tax* is based on all personal-consumption disbursements in money or money's worth during an annual period. Individuals and Hindu undivided families having an *income* of over Rs. 36,000 ($7,560) during the annual period covered are subject to tax. Some classes of expenditure are exempted regardless of amount, while others, being usually in the nature of basic living costs, are exempted up to maximum amounts. There is no exemption for expenditure out of agricultural income. Certain expenditures made by persons other than the taxpayer are included in the tax base as if made by him.

[9] The Constitution of India allocates the power to tax agricultural *income* to the states rather than the central government.

[10] Vol. II, p. 21; cf. also Vol. II, p. 134. The writer has been unable to obtain up-to-date information on the number of persons subject to the income tax.

[11] The Constitution of India allocates the power to tax agricultural *land* to the states rather than the central government.

[12] See the preface to C. V. Parekh, *The Law and Practice of Wealth Tax in India* (Bombay: Parekh & Company, 1958).

After an initial allowance which is normally Rs. 30,000 ($6,300), the rate of tax ascends from 10 per cent on the first Rs. 10,000 of expenditure to 100 per cent on all expenditure over Rs. 50,000 ($10,500). Prior to any experience under the act the number of persons expected to be subject to the tax was estimated at 5,500 individuals and 1,000 Hindu undivided families.[13] A change in the provisions of the act, which was made subsequent to the preparation of this estimate, would seem to require that the estimate be revised upwards.[14] Although an expenditure tax has long been proposed and discussed by economists, including John Stuart Mill, Alfred Marshall, Irving Fisher, and Nicholas Kaldor, India is the first nation to enact such a tax.

III. DEFINITIONS OF THE ECONOMIC CONCEPTS

Income, net wealth, and expenditure may be defined so as to stand in a relationship to each other in the following way:

Opening net wealth + Income
− Expenditure = Closing net wealth.

Opening net wealth is defined as the net value of the taxpayer's property at the beginning of the tax year. Income is defined as the sum of all positive value which accrues to the taxpayer during the year, less the sum of all negative value which accrues to the taxpayer during the year and is not an expenditure. The positive items in income are gains from business or employment, gains from increases in the value of capital whether realized or unrealized, gratuitous receipts and casual gains. The negative items in income are losses from business, losses from decreases in the value of capital whether realized or unrealized, and casual losses (or other negative items not included in expenditure). Income may represent either a net increase or net decrease in value and may accordingly be either positive or negative. This definition would appear to conform to what is known as the net accretion concept of income.[15]

Expenditure is defined as the sum of all amounts expended by the taxpayer during the year, other than business expenses or capital outlays, and including the decrease in value of consumer capital. It thus consists of consumption by the taxpayer, gratuitous transfers made by him, and certain other items (such as payment of non-business taxes). Closing net wealth is defined as the total value of the taxpayer's property at the end of the year.

Another way of stating the above equation brings out the relationship between income, savings or dissavings, and expenditure. Savings may be defined as

13 "Memorandum Prepared by the Ministry of Finance Explaining The Taxation Proposals In The Finance (No. 2) Bill, 1957 And The Provisions of the Wealth Tax Bill, 1957 and the Expenditure Tax Bill, 1957."

14 Under the Expenditure Tax Bill, on the basis of which the estimate was prepared, all individuals and Hindu undivided families whose income for the purpose of the income tax exceeded Rs. 60,000 were subject to tax. Under the Act, individuals and Hindu undivided families who have income of Rs. 36,000 are subject to tax without regard to the amount of their income for purposes of the income tax.

15 A net loss in value would represent negative income. This concept of income is also known as the Haig-Simons concept. See R. M. Haig, *The Federal Income Tax* (New York: Columbia University Press, 1921); Henry Simons, *Personal Income Taxation* (Chicago: The University of Chicago Press, 1938). It is by no means the only economic concept of income. See Brownlee and Allen, *Economics of Public Finance* (New York: Prentice-Hall, 1954, 2nd ed), pp. 242-47; and L. H. Seltzer, *The Nature and Tax Treatment of Capital Gains and Losses* (New York: National Bureau of Economic Research, 1951), Chapter 3.

the change in net worth of the taxpayer, or the amount by which closing net wealth exceeds opening net wealth. A negative result, or excess of opening net wealth over closing net wealth would indicate a dissavings. Since income equals expenditure (or consumption) plus savings:

Income – (Closing net wealth
– Opening net wealth) = Expenditure.

The relationship which is expressed by the above equation might serve either of two basic functions. If the items of income, net wealth, and expenditure were each determined independently, the equation could be used as a means of reconciliation. By its use the returns for each of four taxes (the taxes on net wealth at the beginning and the end of the year, and the taxes on income and expenditure during the year) could be checked against each other. Inaccuracies in the reporting of one of the taxes would be revealed except when they paralleled or were compensated for by inaccuracies in another tax. Evasion would not be precluded but would need to be consistent and thorough.

If income, net wealth and expenditure are not each determined independently, the equation might serve a different function. The equation might then be used as a means of determining income or expenditure. Income or expenditure would be a residual item derived from independent determinations of the other items in the equation.[16] If the equation is used as a means of deriving income or expenditure, it cannot also be used as a means of checking the returns for various taxes against each other. The equation can serve either of the two basic functions, but not both.

Differences Between Tax and Economic Concepts

There is no system of income taxation in which taxable income is identical with net accretion income. No income tax includes gifts or inheritances in taxable income or normally takes unrealized changes in the value of property into account. Income taxes sometimes permit special allowances for reasons of economic policy. Examples are rapid depreciation, depreciation in excess of cost, and percentage depletion. Other provisions which affect taxable income are based on reasons of social policy. Examples are afforded by various personal expense deductions, the disallowance of illegal costs, and the exemption of interest on certain governmental obligations.

In the case of the Indian income tax (which is modeled on the British income tax) taxable income differs from accretion income for another reason. The tax is based in part on a different concept of economic income, namely, the concept of recurrent receipts. A tax which adhered fully to the concept of recurrent receipts would differ from a tax based on accretion income in the following respects. There would be no allowances for depreciation, depletion, or amortization; casual and nonrecurring receipts, including capital gains, would not be taxable. Taxable income in India differs from accretion income in that there is no provision for depletion or for the recovery of the cost of an annuity, capital gains are taxed separately and under certain conditions only, and casual

[16] It might seem that the equation is not suitable for this purpose for the reason that unrealized changes in the value of net wealth cannot be accurately measured. However, this objection does not apply to the extent to which unrealized changes in net wealth are excluded from both income and net wealth.

receipts, such as lottery winnings, are exempt.[17]

Taxable net wealth will differ from economic net wealth for various policy reasons, including reasons relating to administration. In India, the net wealth of a business may, presumably for reasons of administration, be stated at book value, a method which does not ordinarily take into account unrealized changes in value (except in the case of certain assets). Agricultural land is exempted from the Indian net wealth tax for constitutional reasons, and a long list of assets (e.g. pensions, annuities, insurance, short-term interests, works of art, certain governmental obligations) are exempted for various reasons.

Taxable expenditure will similarly differ from economic expenditure. Items which would be included in economic expenditure, but which are not included in taxable expenditure under the Indian expenditure tax include the following: gifts, certain types of personal insurance, expenditure on immovable property for personal use, charitable contributions, and non-business expenditures in civil or criminal proceedings.

Derivation of the Economic Concepts by Adjustment of the Tax Concepts

The relationship between the economic concepts of income, net wealth, and expenditure, cannot serve a useful function unless the economic concepts can be derived by adjustments of the tax concepts. This is true whether the relationship is to be used to check independently determined amounts against each other or to derive one amount from the others. The following example will illustrate the necessity for adjustments and the steps which would be taken in adjusting taxable income to arrive at economic income.

Assume that the opening net wealth of Taxpayer A is as follows:

Annuity	Rs. 100,000
Business	100,000
Securities	50,000
Vacant land	100,000
	350,000

Assume further that during the year the taxpayer has taxable business income of Rs. 15,000. Since that figure is after subtracting an investment incentive allowance of Rs. 2,000, the economic income from his business is Rs. 17,000. The taxpayer withdraws the economic income of Rs. 17,000 from his business. The value of the business remains unchanged at Rs. 100,000. The taxpayer has taxable income of Rs. 10,000 from his annuity. Since this figure includes Rs. 7,000, which represents the recovery of cost, the economic income from the annuity is Rs. 3,000. The value of the annuity at the end of the year is Rs. 93,000, the reduction in value representing only the recovery of cost of Rs. 7,000. The securities valued at Rs. 50,000 at the beginning of the period cost the taxpayer Rs. 48,000. During the year these securities advance in price to Rs. 52,000 and are sold at that price. The taxpayer retains Rs. 2,000 and reinvests Rs. 50,000 in other securities which continue to be worth Rs. 50,000 at the end of the year. During the year the vacant land held by the taxpayer increases in value from Rs. 100,000 to Rs. 125,000. During the year the taxpayer receives a bequest of Rs. 8,000 and has lottery winnings of Rs. 3,000.

[17] Depreciation is now allowed in Great Britain but not in all cases. The cost of certain annuities purchased from life-insurance companies can now be amortized; the cost of other annuities cannot. There is no depletion. Capital gains and "casual" gains are not taxed.

The taxpayer's taxable income and economic income are as follows:

Economic income

Business	Rs. 17,000
Annuity	3,000
Capital gain	2,000
Bequest	8,000
Lottery winnings	3,000
Land value increase	25,000
	58,000

Taxable income

Business	Rs. 15,000
Annuity	10,000
	25,000

During the year the taxpayer's receipts are as follows:

Withdrawn from business	Rs. 17,000
Annuity receipts	10,000
Retained from proceeds of securities sale	2,000
Bequest	8,000
Lottery winnings	3,000
	40,000

The taxpayer expends Rs. 28,000 and deposits the remaining Rs. 12,000 in a bank account. Closing net wealth is as follows:

Annuity	Rs. 93,000
Business	100,000
Securities	50,000
Vacant land	125,000
Bank account	12,000
	380,000

If unadjusted taxable income is used in the equation linking income (I), net wealth (NW), and expenditure (E), the defined equality does not hold, as follows:

$$NW_o\ (350{,}000) + I\ (25{,}000) - E\ (28{,}000) \neq NW_c\ (380{,}000).$$

If, however, taxable income is adjusted to economic income, the equality holds:

$$NW_o\ (350{,}000) + I\ (58{,}000) - E\ (28{,}000) = NW_c\ (380{,}000).$$

It should also be noted that taxable net wealth and taxable expenditure would need to be adjusted in a manner similar to that in which taxable income is adjusted in the example if there are differences between the taxable and economic concepts.

IV. KALDOR'S SUGGESTED RETURN FORM FOR INDIA

The comprehensive return form suggested by Kaldor for India does not employ the equation which links income, net wealth, and expenditure. The form does provide for (1) the derivation of expenditure by adjustments to taxable income,[18] (2) the balancing of accruals and disposals,[19] and (3) the reconciliation of opening and closing net wealth without reference to income or expenditure.[20]

1. *Derivation of Expenditure*

The basic principle by which expenditure is determined under the suggested form is as follows:

Accruals − Capital disposals = Expenditure.[21]

Accruals are determined by adding the following items to taxable income: receipts for gratuitous transfers, proceeds from the sale of assets, receipts from

[18] Kaldor, *Indian Tax Reform:* Appendix A, Statement G: Personal Expenditure.

[19] *Ibid.*: Appendix A, Summary Statement II: Accruals and Disposals.

[20] *Ibid.*: Appendix A: Summary Statement I: Capital Position.

[21] The basic principle is that suggested by Irving Fisher. See footnote 24 *infra.* And see Kaldor, *An Expenditure Tax,* p. 12. The fact that this is the basic principle behind Statement G can be discerned by observing Summary Statement II and noting that the amount shown on Statement G, when added to capital disposals, is expected to equal accruals.

borrowings and repayment of past loans, and other casual or capital receipts. Capital disposals are the sum of the following items: outlay on gratuitous transfers,[22] purchases of capital assets, lending or debt repayments and other capital payments.

Kaldor's method of determining expenditure will yield a correct result only if certain adjustments, which are not provided for in the suggested form, are made. This point may be illustrated by applying the suggested method to the facts set forth above in the hypothetical case of Taxpayer A. Application of Kaldor's method to those facts yields the following incorrect result:

Taxable income	Rs. 25,000
plus	
Bequest received	8,000
Proceeds from sale of securities	52,000
Lottery winnings	3,000
	88,000
less	
Purchase of securities ..	50,000
Bank deposit	12,000
Expenditure	26,000

The actual expenditure was Rs. 28,000. The discrepancy is attributable to the fact that accruals included Rs. 2,000 of economic income from business which was not included in taxable income. The Rs. 2,000 discrepancy between economic business income and taxable business income is attributable in our hypothetical case to an investment allowance, which is used as an example of a provision which will produce such a discrepancy.[23] Appropriate adjustments would need to be made for all provisions of law which have this effect.

The amount of Rs. 7,000, while a capital recovery of the annuity, was not added as a capital receipt since it was already included in taxable income. The Rs. 2,000 capital gain was not included in taxable income because capital gains up to Rs. 4,000 are exempt in India. Were it included in taxable income, its inclusion also in the proceeds from the sale of assets would result in double counting and an overstatement of expenditure. This could be handled either by then subtracting the gain from taxable income or from the proceeds from sale of assets. Subject to the above qualifications, the suggested method should result in a correct determination of expenditure.

2. *Balancing Accruals and Disposals*

The suggested form contains a statement in which the total accruals of the taxpayer are to be balanced against his total disposals. The statement is not an independent reconciliation but is rather an alternative presentation of expenditure and of accruals and capital disposals, —the items which are used, elsewhere on the form, in arriving at expenditure. Accruals, as in arriving at expenditure, are the sum of *receipts* from the following sources: taxable income, gratuitous transfers, the sale of capital assets, borrowings and repayments of past loans and other capital transactions. Disposals are the sum of capital disposals (consisting of the following *outlays:* gratuitous transfers, purchases of capital assets, lending and/or debt repayments, and outlays on other capital transactions)

[22] In the suggested form, gifts made by the taxpayer are thus treated as not being within the concept of personal expenditure. Under the analysis suggested in this paper such gifts would be included in the economic concept of expenditure.

[23] The disallowance of illegal costs would be an example of a provision which would produce a discrepancy in the other direction, making taxable business income greater than economic business income.

and expenditure. Inasmuch as expenditure is arrived at, elsewhere on the form, by subtracting capital disposals from accruals, it follows that the total disposals (which are the sum of capital disposals and expenditure) will equal total accruals. Accruals and disposals will accordingly balance irrespective of whether expenditure is correctly determined.

3. *Reconciliation of Opening and Closing Net Wealth*

The suggested return form provides for a reconciliation of opening and closing net wealth. However, the reconciliation is not made by reference to income and expenditure. The proposed reconciliation appears rather to provide for a reconciliation by reference to changes in the taxpayer's capital accounts.

The reconciliation of opening and closing net wealth which is contained in the suggested return form is quite puzzling. As applied to some hypothetical cases, including that of Taxpayer A, the proposed reconciliation does not bring the correct result.[24]

A correct reconciliation of opening and closing net wealth by means of changes in the capital accounts, rather than by means of income and expenditure, could be constructed.

The operation of this type of reconciliation may be described by means of the following set of related definitions. Opening net wealth is the total value of all the taxpayer's property at the beginning of the tax year. Capital accruals are all amounts realized by the taxpayer from capital during the year. Capital disposals are all amounts contributed by the taxpayer to capital during the year. Closing net wealth is the value of the taxpayer's property at the end of the year. It follows from these definitions that opening net wealth plus capital disposals less capital accruals plus or minus unrealized changes in the value of closing net wealth will equal closing net wealth. Excluding unrealized changes in value, opening net wealth plus capital disposals minus capital accruals will equal closing net wealth.[25]

V. THE MEASURES ENACTED IN INDIA

In India the taxes on income, net wealth, and expenditure are assessed under separate statutes and reported on separate returns. There is no provision for a comprehensive return or for the reconciliation of the amounts shown on the separate returns. Since income, net wealth, and expenditure are determined independently of each other, the relationship among these items might be

[24] In effect, "Summary Statement I: Capital Position" provides that the following items shall be respectively added to or subtracted from opening net wealth in arriving at closing net wealth. To be added: gratuitous transfers made by the taxpayer, purchases of capital assets, outlays on borrowing and lendings, and other capital or casual payments. To be subtracted: gratuitous transfers received by the taxpayer; sales of capital assets, receipts from borrowing and lendings; and other capital or casual receipts. Applying these instructions to the case of Taxpayer A, we obtain the following

Opening net wealth		Rs. 350,000
plus		
Securities purchases	Rs. 50,000	
Bank deposit	12,000	
		62,000
less		
Bequest	8,000	
Securities sales	52,000	
Annuity capital	7,000	
Lottery winnings	3,000	
		70,000
Closing net wealth exclusive of unrealized changes in net wealth		342,000
plus		
Unrealized change in land value		25,000
Closing net wealth		367,000

(Kaldor's form of this reconciliation does not provide for an adjustment for unrealized changes in

used as a means of checking them against each other. The expenditure-tax return provides for the partial determination of expenditure by an indirect method.[26] Personal expenditure which appears in the taxpayer's business accounts is taken from those accounts. Other expenditure is determined by an indirect method proposed by Fisher and adopted by Kaldor in his suggested return form, namely, the subtraction of capital disposals from accruals.[27] The Indian expenditure-tax return differs from that suggested by Kaldor in that taxable income as such does not enter into the computation. Accruals are determined directly rather than by adjustments to taxable income. Nevertheless, insofar as the indirect method is employed, the determination of expenditure is not wholly independent of the determination of income. An understatement of accruals will automatically result in an understatement of expenditure.

The returns for income, net wealth, and expenditure could be reconciled by the use of the equation linking economic income, economic net wealth and economic expenditure. But in order to use the equation for this purpose it would be necessary to derive the economic concepts from the taxable amounts by adjustments of the type described above. Some further points concerning these required adjustments, although they are not necessarily peculiar to India, may be made in the context of the Indian statute.

Returns of income, net wealth, and expenditure cannot be reconciled unless the dates for the reporting of opening and closing net wealth and the periods for the reporting of income and expenditure are co-ordinated. The fiscal periods for the reporting of all income and expenditure must be the same, and net wealth must be reported at the opening and close of the fiscal period. Under the Indian income tax different fiscal years may be adopted for the reporting of income from different sources. The fiscal year for purposes of the expenditure tax is the same as for income-tax purposes. When the taxpayer employs different fiscal years for different sources of income, the fiscal year for expenditure-tax purposes is that which expires last. Net wealth is reported at the opening and close of the fiscal year for purposes of income tax. When the taxpayer has adopted different fiscal years for different sources of income, net wealth is reported at the opening and close of the fiscal year which expires last. Thus the dates for the reporting of net wealth and the periods for the reporting of income and expenditure are co-ordinated, except in those cases in which the taxpayer has adopted different fiscal years for different sources of income. In those cases it would be

value. This would not be necessary because under his proposed system of taxation net wealth would be valued at book value).

[25] This equation might be expressed as follows:

$$(1)\quad NW_o + CD - CA = NW_c.$$

The equivalence of this equation with the basic equation set forth earlier in this paper may be demonstrated as follows. Unrealized changes in the value of closing net wealth are unrealized income. If we exclude such unrealized income from closing net wealth the basic equation will be as follows:

$$(2)\quad NW_o + \text{Realized Income (RI)} - E = NW_c.$$

We may assume by way of definition that:

$$(3)\quad RI + CA = E + CD.$$

Then,

$$(4)\quad RI - E = CD - CA.$$

[26] The Expenditure-Tax Rules, 1958, Rule 3, Form A.

[27] Fisher's ideas on the matter appear in popular form in Fisher and Fisher, *Constructive Income Taxation* (New York: Harper and Brothers, 1942). An earlier and more rigorous treatment is to be found in his article, "Income in Theory and Income Taxation in Practice," *Econometrica*, Vol. V (Jan., 1937), pp. 1-55.

necessary to make a special computation of income for the purpose of reconciliation. For that purpose it would be necessary to compute income from all sources for the fiscal year which expires last.

Under the wealth tax, unrealized changes in the value of net wealth are not always taken into account. Business assets may be valued at book value. In India, as elsewhere, unrealized income is not taxed. To the extent to which unrealized changes in the value of net wealth are not taken into account, it is unnecessary to adjust either income or net wealth. In this respect the statutory variations from the economic concepts parallel each other and simplify the adjustments required.

Exemptions are numerous and significant under the Indian statutes, particularly under the wealth tax. A reconciliation would require that the amount of exempt income or expenditure or the value of exempt wealth be determined and added back. Perhaps the most notable exemption relates to agriculture.[28] Adding back the exempt items will often require records and valuations which would not otherwise be necessary.

International aspects may require that information be obtained for purposes of reconciliation which is not needed for the purpose of the separate returns. The reconciliation is only accurate if income, net wealth, and expenditure are reported on a world-wide basis. Under the enacted measures the reporting of all three taxes must be on a world-wide basis only in the case of taxpayers who are citizens of India and are resident in India.

[28] For constitutional reasons agricultural income and land are not taxed under the income or wealth taxes. Expenditure out of agricultural income is included in taxable expenditure.

Under the enacted measures certain assets and items of income and expenditure are attributed to persons other than those actually owning, receiving, or disbursing them. In some cases transferred assets, the income from such assets, and expenditure out of the transferred assets or income produced by them will all be attributed to the taxpayer. In such cases it would seem that all the attributed items could be included in the reconciliation.

When all three items relating to given assets (i.e., the assets themselves, the income from such assets, and expenditure out of the assets) are not attributed it will be necessary either to eliminate the attributed items from the reconciliation or to add in the items which are not attributed. Eliminating attributed items will make the reconciliation inoperative with respect to those items; adding in items not otherwise attributed will introduce additional complexities.

VI. THE OUTLOOK FOR TAX ADMINISTRATION IN INDIA

As indicated in the description of the expenditure tax, a very limited number of persons are estimated to be subject to the Indian expenditure tax. It would seem that most of these persons will also be subject to the wealth and income taxes.[29] When taxpayers are subject to all three taxes, administration may perhaps be improved by checking the returns against each other. The reconciliation, as indicated in this paper, is a complex process. It is no guarantee against thorough and consistent evasion. However, the combination of measures may make evasion more difficult inasmuch as there will be more chances that

[29] There may be exceptions in the case of persons whose income and wealth are exempt either as agricultural income and land or otherwise.

a discrepancy between the actual and the reported facts may be brought to light.

The new measures should aid the administration of the income tax by making available relevant information concerning net wealth and expenditure on a systematic basis. It would seem that such information might be used for an approximate checking of income by reference to net wealth and expenditure without becoming involved in the complexities of a precise reconciliation. It should be noted, however, that information regarding net wealth and expenditure could be required on a systematic basis apart from the enactment of wealth and expenditure taxes.[30] The benefits to administration which may arise from the additional data furnished by wealth- and expenditure-tax returns ought not to be regarded as an intrinsic merit of wealth and expenditure taxes as such. They are rather a useful by-product of such measures which may also be obtained in other ways.

There are contrary considerations from an administrative point of view. Both the wealth tax and the expenditure tax involve substantial complexity on their own account. The administration of the Indian income tax has been difficult.[31] The new measures charge those administering the income tax with two complicated new measures. The over-all result may be to weaken the administration of all the taxes.

The relatively small number of persons subject to the income tax has made administration easier, but at the same time limited its potential. The administrative burden imposed by the new measures is lessened by the fact that they apply to a still smaller number of taxpayers than does the income tax. In any event, the new measures may result in an expenditure of scarce administrative talent and energy on the application of an inordinately complex set of measures to a small group of taxpayers.

[30] Since 1953 the income-tax authorities have been specifically authorized by the statute to call for a net-worth statement as a regular part of the assessment procedure. The Taxation Enquiry Commission 1953-54 recommended that net-worth statements be regularly called for in certain cases at three-year intervals.

[31] See footnote 3, *supra.*

PATTERNS IN LOCAL FINANCE: THE CASE OF ORLEANS COUNTY, VERMONT *

LLOYD SAVILLE †

I. *Introduction*

SMOKING in the Paris Metro is still prohibited by an order of the occupation authorities in 1942.[1] This unimportant but evident example appearing on hundreds of subway car windows characterizes the frequent dependence on external or revolutionary forces to initiate change in the public sphere. Perhaps recurrent revolutions, wars, and crises provide modifications in the social area to match evolutionary mutations in the physical world.

Some empirical verification of this and related concepts may be developed from the financial records of small communities. Free of much complexing detail found in urban and larger governmental bodies, small towns encounter many of the same fundamental problems as larger units. Although economies of scale are not as acutely evident, the limited size and large numbers of these minor bodies permit not only the identification of patterns of group decision making but also the measurement of the range of variation in public activities. Furthermore, concentration on a small sample of towns enables the investigator to explore in sufficient depth to untangle confusing skeins and to bring order to a maze of numerical information.

By using the local community as a model of the general mechanism of public finance, some evidence may be obtained concerning the following questions: (1) What influences motivate change in local public income and expenditure patterns? (2) What *de facto* fiscal policy has been followed by local communities? (3) Have the comparative shares of the public and private sectors of the economy changed?

Selected for investigation are the towns in Orleans County, Vermont. One of several sample regions being examined in a larger, comparative study of local income and expenditure, Orleans County provides a profitable source of data concerning the behavior of small units. Here in New England the unimportant county is divided into relatively autonomous towns, the primary organ of local government. Fundamentally democratic, the open town meeting is still utilized as a forum for the taking of detailed administrative actions in an area of immediate concern to the group, local public finance. Besides meeting the general requirement of similarity with other comparable areas in the larger study, Orleans County is both representative of Vermont as a whole [2] and suit-

* My colleague, Professor Frank T. de Vyver, and my former colleague, Professor Wylie Kilpatrick, made several helpful suggestions concerning a draft of this paper.

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[1] Gold and black lettering reads:

Defense de Fumer
Les contravenants s'exposent
a des poursuites correctionelles
(Art. 74 du Decret du mars 1942).

[2] The ranking of Orleans County among fourteen counties in Vermont according to median values in

able for a study in depth. Population density, natural resources, employment activity, and even institutional heritage differ little from unit to unit. With these important rubrics held constant, variations in local financial practices may be examined in an environment free of many complexing influences.

1950 of the towns in the counties is as follows:

Measure	Rank (where 1 is lowest)
Density of population	5
Income of families	4
Percentage of population gainfully employed	2
Per capita assessment	11
Miles of highways per person ..	10
Per capita school attendance ..	9

Sources: Population, income, and employment data from Bureau of the Census, *United States Census of Population: 1950*, Vol. II, *Characteristics of the Population*, Part 45, Vermont, Chapter B (Washington: U. S. Government Printing Office, 1952), pp. 13, 38, and 39; assessment information from *Biennial Report of the Commissioner of Taxes of the State of Vermont* for the term ending June 30, 1950, pp. 12-27; highway data from State Highway Board, *A Report on Vermont Highways*, July 1, 1948 to June 30, 1950, p. 49; and school attendance from Division of Educational Planning, Department of Education, *Statistics of Vermont School Systems*, 1949-1950, Supplementary Report No. 50-05, p. 2.

According to the measures shown here the relative standing of Orleans County varies widely among the counties of Vermont. Standings differ by statistics both of general importance (population, income, and employment) and of public financial relevance (assessment, road mileage, and school attendance). Apparently, however, the first three measures tend to place Orleans among the poorer counties, while the last three suggest public activities somewhat higher than the average.

It may be noted also that, at the county level, rank correlations (showing significance by use of Spearman coefficients) reveal, as might be anticipated, a moderate inverse correlation between per capita assessments and densities of population, and a slight positive correlation between assessments and gainful employment. This latter correlation implies perhaps that Orleans County may be unusual in having a high assessment rate coupled with a low percentage of gainful employment. In spite of this minor exception these measures reveal no substantial uniqueness that would tend to make the choice of Orleans County generally unrepresentative of the state as a whole or inappropriate for this study.

II. *Economic Characteristics of Orleans County*

As is well known, Vermont since its inception as a state in 1791 has had an essentially rural economy in which extractive industries, notably agriculture, contribute a major share. Furthermore, because of the system of electing one state representative from each town regardless of size, here as they have in other sections of the United States, rural areas and farmers in particular have had a more than proportionate voice in legislative decisions. Also, population growth and urban development have been relatively modest. In fact several areas achieved population peaks as early as 1830 and 1840, and still no large cities exist within the state.

Located in north-central Vermont in a section producing forage crops, Orleans County has depended increasingly on dairying as its primary source of income. More recently, however, tourism, especially the provision of summer vacation facilities, has gained in importance as a major class of revenue. Absence of urban centers and a heavy concentration on livestock production effectively limit population growths as a rural-urban migration and improvements in farm productivity channel inhabitants to other regions.

In the County some residents have been satisfied with the collective facilities provided by the township. Others have required special services for their particular section and have created smaller administrative subdivisions such as villages or fire districts to fulfill their wants. Among the eighteen towns in Orleans County at the decennial census of 1950, eight of them contained one or more of these subsidiary units and only ten functioned without specially incor-

TABLE I

TAXES LEVIED PER CAPITA IN CONSTANT DOLLARS AND RANKINGS BASED THEREON FOR ORLEANS COUNTY TOWNS WITHOUT INCORPORATED SUBDIVISIONS FOR SELECTED YEARS, 1885–1950

Class and town	Taxes levied per capita in constant dollars						Rankings of taxes levied per capita					
	1885	1910	1920	1930	1940	1950	1885	1910	1920	1930	1940	1950
Predominantly high rates												
Westmore	$20	$28	$36	$73	$90	$59	9	10	10	10	10	8
Morgan	13	23	32	45	52	64	5	7	7	9	9	9
Craftsbury	20	24	32	39	47	55	10	8	6	8	7	7
Predominantly medium rates												
Irasburg	17	27	35	36	41	54	8	9	9	2	5	6
Charleston	14	20	33	44	51	47	6	5	8	8	8	3
Lowell	12	18	37	37	38	73	4	4	5	3	3	10
Holland	9	21	24	39	37	47	1	6	4	7	2	4
Predominantly low rates												
Brownington	15	15	22	29	31	32	7	1	3	1	1	1
Jay	11	17	18	38	47	41	2	2	1	5	6	2
Westfield	11	17	21	37	40	54	3	3	2	4	4	5

Source: Taxes levied include poll taxes and are the product of tax rates and grand lists. They were derived from the following state reports and have been checked where possible with reports of individual towns: 1885—Charles W. Porter, Secretary of State, *Statistical Information Relative to the Rates of Taxation in the Several Towns, Cities and Gores in Vermont for and During the Years 1884 and 1885* (Boston: Franklin Press, 1886), p. 28; 1910—*Biennial Report of the Secretary of State of the State of Vermont for the Two Years Ending June 30, 1910*, p. 13; subsequent years included in *Biennial Report of the Commissioner of Taxes of the State of Vermont:* 1920—for the Term Ending June 30, 1920, pp. 56–121; 1930—for the Term Ending June 30, 1930, pp. 92–111; 1940—for the Term Ending June 30, 1940, pp. 25–38; and 1950—for the Term Ending June 30, 1950, pp. 12–26. Per capita computations are based on decennial population data of the U. S. Bureau of the Census, for 1885 a simple mean of the 1880 and 1890 figures was employed. And, constant dollars were achieved by use of the Consumers' Price Index of the Bureau of Labor Statistics for years beginning in 1919—Bureau of the Census, *Continuation to 1952 of Historical Statistics of the United States*, 1789–1945 (Washington: U. S. Government Printing Office, 1954), p. 68—and the Cost of Living Index of the Federal Reserve Bank of New York for the years prior to 1913—Bureau of the Census, *Historical Statistics of the United States*, 1789–1945 (Washington: U. S. Government Printing Office, 1949), p. 235. All values have been rounded to even dollars.

porated subdivisions. The finances of these latter, simpler forms, will be explored first.

Classification of the ten towns according to local taxes is a convenient first step in judging their income-expenditure practices. Two adjustments have been made in the basic data. Since property valuations vary greatly from town to town, comparability of rates between towns has been improved by stating them as taxes levied per capita.[3] And, because of persistent fluctuations in the value of money over time, results throughout have been converted to constant (1947-1949) dollars.

[3] Commission to Study the Question of Taxation (Meredith Commission), *Report of Commission to Study the Question of Taxation* (Montpelier, Vermont: Capital City Press, 1952), pp. 78-82. The ubiquitousness of this problem is noted in J. R. Hicks, U. K. Hicks, and C. E. V. Leser, *The Problem of Valuation for Rating*, National Institute of Economic and Social Research, Occasional Paper VII (Cambridge: Cambridge University Press, 1944), p. 2.

In Table I, towns with simple organizations are divided into three groups: those with predominantly high tax rates, those with medium rates, and those with low. Towns with high rates—Westmore, Morgan, and Craftsbury—have maintained high levels for fifty years or more. Each of these contains attractive resort or retirement areas. The town of Westmore includes Lake Willoughby, noted since the founding of a public house and summer resort at its south end in 1850 as a vacation spot of repute.[4] Morgan with its Lake Seymour and Craftsbury with its hilltop scenery and residential antiquity complete this group of high rate communities.[5]

At the other extreme are the generally rugged, unfertile terrains of Brownington, Jay, and Westfield, where incomes from haying and grazing are augmented by selling wood for pulp. Brownington, located in an isolated and primitive area, still has no paved roads through the center of town and still receives complaints from farmers suffering losses of stock caused by bear. Jay and Westfield, situated on the western mountain fringe of the County, complete this generally consistent group of poor farming communities. Between these extremes is a group of four towns, Irasburg, Charleston, Lowell, and Holland. All possess large areas of good farm land supplemented in some by a smattering of other special resources such as timber, streams, and small lakes.

[4] Abby Maria Hemenway (Ed.), *The History of Orleans County, Vermont* (White River Junction, Vermont: White River Paper Company, 1882), p. 366.

[5] J. R. and U. K. Hicks in *Standards of Local Expenditure: A Problem of the Inequality of Incomes,* National Institute of Economic and Social Research, Occasional Paper III (Cambridge: Cambridge University Press, 1943), pp. 19-20, also found that wealthier towns levied higher tax *rates* than poorer towns and that vacation areas, "seaside resorts," levied the highest rates of all.

III. *Revenues of Irasburg, Orleans County*

Employing Irasburg as a town generally representative of the simple towns in Orleans County is a way of extending the inquiry both in time and topic. In a sense it is a median town. In Table I it was shown that on a tax basis this town lay midway between towns levying high rates and those imposing low ones. In a sense also it is a modal town. For Irasburg's population peak occurred in 1860, the decennial census year in which most Orleans County towns reached their highest populations.[6]

Organized in 1793 and fostered in its early development by the machinations of the Allens,[7] it became the county seat

[6] Nominally, towns are six miles square; they vary somewhat from this, however, and their areas, exclusive of rivers and lakes, range from twenty-five to fifty-two square miles. A minor amount of industrialization and commercialization in a few sections has netted a growth in population density for the county as a whole, but the associated movement of persons from farms has resulted in a decline in density in the agriculturally centered townships. As Orleans County towns grew and then declined, Irasburg has remained close to the median of their population densities.

[7] Irasburg is well named. In spite of the equalitarian motives for preserving northern Vermont lands from encroachment by the large estates of New York and the requirement that town proprietors number between forty and seventy individuals, General Ira Allen obtained ownership of the whole town of Irasburg, except for the usual public lands (five, of the total seventy rights, of 351 acres each for the state college, the first settled minister, the support of the ministry, the county grammar school, and an English school). In 1789 he gave to his daughter-in-law, Jerusha Enos, Jr., the ". . . domain that I have unto the township of Irasburg . . . which was granted to me and sixty-four associates by the Legislature of Vermont and all my associates named in the Charter of the Town have given and ceded to me of their respective Rights . . . as a marriage settlement . . . ." (*Proprietors Records Irasburg,* Vol. 1, 1801-1807, p. 179). Failure to pay surveying costs and a three cents per acre legislative tax for road development resulted in the sale of the town in 1803 and again in 1806 to Herman Allen (adopted son of Ira and apparent agent for one or more Allens). In fact, dis-

in 1816. Expanding, a bank was chartered in 1830 and a newspaper in 1845.[8] Beginning about 1860, however, in competition with the superior mill sites and better transportation facilities of other towns, Irasburg lost progressively population, newspaper, bank and county seat.

Irasburg secures revenue from three primary sources: a property tax which has accounted for the major portion of its income in the past century and a half, a poll tax which has fluctuated in importance, and a variety of grants in aid from the State which in recent years have grown from minor to major consequence.[9] In addition to these three a series of continuing minor sources such as license fees for dogs, liquor sales, and some businesses provide a modest amount of additional income.

Although Vermont's constitution is based with Pennsylvania's on William Penn's *Frame of Government*,[10] its political machinery and customs bear more resemblance to the English common-law parishes of the sixteen hundreds acclimated by decades of use in Massachusetts and Connecticut.[11] Constable, surveyor of highways, overseer of the poor were all local-government officials in seventeenth-century England as they are in Irasburg today.[12] And the basic " rate " on property still accounts for a substantial majority of the Town's income as it did in the boroughs of Queen Elizabeth's day.[13]

Early progressive features of a property tax based on the " grand list " or statement of property valuations,[14] the classification of property for tax pur-

putes arising over the legality of these actions by the proprietors were settled with the aid of a statute of the State dated October 1804 entitled, *An Act enabling the Proprietors of Irasburg to ratify and confirm their former proceedings.* (*Ibid.*, pp. 24-7 and *Laws of Vermont* [*October*] *1804* [Bennington: Haswell and Smead, 1805], Ch. 30, pp. 30-1). Ownership thus protected by vendue deeds by two tax collectors, one Joseph Scott and the other Roger Enos, Jr., and an act by the Legislature, lands were leased to settlers (some seventy-five leases by Ira Allen with proceeds in trust for Jerusha Allen appear in *Irasburg Town Records, Deeds*, Vol. 1, 1801-1808, pp. 44-457). Apparently the first deeding of land occurred on August 17, 1807 and the next not until December 3, 1807 (*Irasburg Town Records, Deeds*, Vol. 2, pp. 12-20). Even as late as 1842 the tax list shows Ira Allen, many time Treasurer of the State, owning more than one-third of the land of the Town. Some of these details also appear in accounts by both E. P. Colton in Abby Maria Hemenway, Ed., *The Vermont Historical Gazetteer* (Claremont, N. H.: The Claremont Manufacturing Co., 1877), Vol. III, pp. 239-250; and Hamilton Child, *Gazetteer and Business Directory of Lamoille and Orleans Counties, Vt.* (Syracuse, N. Y.: The Journal Office, 1883), pp. 288^2-288^4.

[8] Newspaper publication included:

The Yoeman's Record, 1845-1850
Orleans County Gazette, 1850-1852
North Union, 1855
Orleans' Independent Standard, 1856-1866
The Green Mountain Express, 1861-1862

cited in Hemenway, *op. cit.*, pp. 253-4; and Winifred Gregory, *American Newspapers 1821-1936* (New York: H. W. Wilson Co., 1937), p. 690.

[9] The only extant record of early Irasburg actions is the longhand minutes of the township meetings kept in the volumes of town records, or beginning in 1900 the copies of the printed reports of town officers prepared for annual meetings. These latter sources give an almost too detailed statement of income and expenditure, for frequently every individual payment is shown by a separate entry. At the same time questions still exist concerning the proper classification of expenditures.

[10] Frederick A. Wood, *The Finances of Vermont*, Studies in History, Economics and Public Law No. 130 (New York: Longmans, Green and Co., 1913), p. 18.

[11] Robert M. Carter, *The Farm Business and Farm Family Living as Related to Land Class in Nine Vermont Towns* (Burlington: Agricultural Experiment Station, 1945), p. 3.

[12] Godfrey Davie, *The Early Stuarts, 1603-1660* (Oxford: The Clarendon Press, 1937), p. 273.

[13] Edwin Cannan, *The History of Local Rates in England*, Second Ed. (London: P. S. Kink and Son, 1912), p. 2.

[14] *Laws of Vermont*, 1797, Ch. XLII, Sect. 2, p. 566, provided for the listing of occupied dwellings, stores, and shops at 2 per cent of value if total valuation was not more than $1,000 and at 3 per cent if total valuation was more than $1,000.

poses, and the heavy reliance on the poll tax for income were superseded between 1824 and 1841.[15] State actions at this time limited the poll to a nominal one dollar and then two dollars per head and placed all general property on the list according to value. In 1804 for example, " four days work on the poll " was the only local tax levied, in 1828 the property tax had been introduced but the poll tax still made up somewhat more than half of the total tax. Subsequently the poll tax continued to decline in importance until 1948 when it amounted to less than one fiftieth of all local taxes. Thus the local tax system given to the Town by the State placed progressively more reliance on property and so tended to resemble still more the practices of the mother country. A final source of local revenue, State aid, only recently has become important. Lumped with the locally anonymous " federal aid," it has grown from less than one-twentieth of local income in 1905 to more than one-third since World War II.

Between 1900 to 1950 total revenue of Irasburg expanded from about $6,000 per year to $70,000, or more than ten times (Table II, Column 2). Part of this growth stems, of course, from the declining value of the dollar, but even when income figures are stated in dollars of constant purchasing power (Column 3) an increase of about four times is evident. If these amounts are now converted into per capita terms to allow for the decline in population (Column 4), the growth amounts to an even larger five times.

Viewing the longer period from 1810 to 1950 the expansion is even more impressive. In current dollars the growth is two hundred times. In spite of difficulties inherent in comparing values over this long an interval, stating amounts in dollars of constant purchasing power permits an approximation of the real growth that has taken place in services performed by the community. In constant dollars the increase is still an impressive seventy-five times. Converted to a per capita base the increase in dollars of constant value is from two dollars per person in 1810 to ninety-five dollars per person in 1950, or some forty fold.

An interpretation of these data, however, must bear two factors in mind. First, the total revenues do not include taxes in kind. Second, in terms of the rapidly growing real incomes of individuals these community revenues probably represented a different proportion of total income than suggested by the dollar values themselves. Adjustment for the first of these factors cannot be made with assurance. Since taxes in kind, such as labor on the township roads or cut firewood for the district school house, became less and less important, both because they were levied less often and because their cash equivalent was more frequently paid,[16] some inherent upward bias persists in the amount shown here. For the second, some adjustment may be attempted. Between 1810 and 1950 real per capita national income in the United States increased more than four fold. If local revenues are adjusted to allow for changes in income, the resulting values show a general estimate of the changing relative importance of local finance in terms of the average amount of money

[15] *Laws of Vermont,* 1825, Ch. IX, Sect. 1-6, pp. 10-14 and *Laws of Vermont,* 1841, Ch. 16, Sect. 1 and 4, pp. 10-11.

[16] Payment in legal tender only was permitted after 1892.

TABLE II

RECONSTRUCTED TOTAL REVENUE OF IRASBURG, VERMONT, IN CURRENT DOLLARS, CONSTANT DOLLARS, CONSTANT DOLLARS PER CAPITA, AND CONSTANT INCOME DOLLARS PER CAPITA FOR DECENNIAL CENSUS YEARS 1810–1950

Year (1)	Total revenue in current dollars (2)	Total revenue in constant dollars (1947–49 = 100) (3)	Total revenue per capita in constant dollars (1947–49 = 100) (4)	Total revenue per capita in constant dollars adjusted for income changes (1947–49 = 100) (5)
1810	$ 351	$ 878	$ 2	$ 9
1820	427	1,554	2	9
1830	1,060	4,649	5	25
1840	1,027	4,044	4	17
1850	2,031	8,910	9	25
1860	4,348	16,853	15	42
1870	4,752	12,342	11	41
1880	4,525	13,386	13	45
1890	5,408	16,389	16	50
1900	6,201	18,345	20	52
1910	11,903	29,319	30	63
1920	30,666	35,783	36	68
1930	28,552	39,988	43	69
1940	33,850	56,510	66	91
1950	69,172	67,288	95	91

Source: 1810–1840, minutes of town meetings, "Irasburg First Book of Town Records," pp. 48, 175, 266, 402 and 410; 1850–1880, "Irasburg Book of Records commencing November 1, 1841," pp. 140, 272, 364, and 455; 1890, "Miscellaneous and Town Proceedings, Irasburg, 1883, p. 25; 1900–1950, *Annual Report of the Officers of the Town of Irasburg* for years ending February 16, 1901, February 7, 1911, February 1, 1921, January 31, 1931, for the Calendar Year of 1940, and for year ending December 31, 1950. Constant dollars computed as in Table I. Adjustment to constant income dollars in column (5) involved the dividing through of the figures in column (4) by an index of per capita national income with a 1947–1949 base. An approximation of Kuznet's net national product, peacetime concept, was attempted in constructing the index. For years 1869 to 1918, inclusive, his decennial averages have been used—Simon Kuznets, *National Product since 1869* (New York: National Bureau of Economic Research, 1946), p. 119; from 1919 to 1943, inclusive, his annual estimates, peacetime concept, were employed (Kuznets, *op. cit.*, pp. 55–56); and since 1943 the Department of Commerce's national income figures were utilized—Department of Commerce, *National Income and Product of the United States 1929–1950* (Washington: U. S. Government Printing Office, 1951), p. 151. To achieve rough price comparability the price indexes noted in Table I have been employed except for the years 1929–1950, inclusive, when the Department of Commerce's Implicit Price Deflators were employed (Department of Commerce, *op. cit.*, p. 146).

income available to residents between these dates.

Any attempt to compare incomes over long time periods involves serious inadequacies. National income estimates extending back into the nineteenth century are based on scanty statistical data. A changing mix of commodities and services, varying incomes from each geographical section, and increasing use of the market mechanism are among the variables for which allowances need to be made. Used with extreme caution, however, the income correction adds one more dimension to the over-all picture of local finance.[17] Column 5 of Table II shows the total revenue per capita adjusted not only for changes in the value of the dollar but

[17] For a more thorough discussion of the statistical problems involved in this question see the author's "Income Change: An Adjustment for Extended Time Series," *Proceedings of the Business and Economic Statistics Section of the American Statistical Association, 1958.*

CHART I

SOURCE: MATERIALS NOTED IN TABLE 2

also for the average increase in the national income. Even after this correction, an increase from nine to ninety-one dollars per person is evident. In dollar terms then, local revenues were ten times as important in 1950 as they were in 1810.

How has this sizable gain taken place? And more important, what motivated it? A year-by-year inspection of the total revenue figures in Chart 1 reveals a number of identifiable increases separated by periods of relative uniformity or mild fluctuations. Like a climber ascending a slippery hill, great gains are sometimes possible but there is always the problem of sliding back. Here it appears that the climber has gained experience and no longer attempts the massive steps he did at first; he seems content to move upward less spectacularly but with more sureness

than at the beginning.

As might be expected the major expansion occurring in 1818 resulted from the improving of communications; to accomplish this the highway tax was increased two and one-half times over the previous year. By 1829, the date of the next substantial expansion, the poor had become a major problem. Although efforts were made to limit it by warning indigent persons out of town,[18] the incidental or town tax which includes the appropriation for the poor, was increased a similar two and one-half times over the year before.

Two factors brought about the increase in 1843: a major change in taxes became effective, the base of the property tax was shifted from a series of schedules to an appraisal of the fair cash value of all property; and, the poll tax was drastically reduced from ten dollars to one dollar per person.[19] Also, the allocation of town expenses was again increased substantially, this time to pay off debts and to prosecute " certain suits of interest to the Town."

Three unrelated events brought about a sizable increase in 1864. Buildings on the poor farm burned and required rebuilding and restocking far beyond the insurance coverage, damages received by Benjamin Hancock amounted to \$3118.05, and the Selectmen were authorized to pay " . . . not exceeding six thousand dollars . . . and deposit such sum of money as may be necessary with the State Treasurer to procure enlistment of Blacks at the South sufficient to fill . . . " the Town's quota of soldiers.[20]

[18] At least fifty-seven families were officially warned out of town by the Constable in the years prior to this meeting, "Irasburg First Book of Town Records," pp. 37-252.

[19] *Laws of Vermont*, 1841, *op. cit.*, pp. 10-11.

[20] "Irasburg Book of Records commencing November 1, 1841," p. 314.

None of the subsequent increases were as large in relative terms as these earlier ones. The long gradual rise beginning just before the turn of the century corresponds to an equally impressive increase in state aid. From a net payment of Town funds to the State in 1900, grants to the town by the State amounted to almost one-quarter of local income by 1916. State aid and the inauguration of fire protection helped to produce the enlargement in 1915, the great flood of November 1927 brought about a sharp rise in the succeeding year, and the first State Old Age Assistance payments produced a moderate increase in 1937. More state aid, this time for highways, and a large increase in the cost of the poor (" the calls upon this department have been numerous and very much involved, with much conflict as to residence of persons desiring aid ") resulted in another expansion in 1949.

Thus, except for the cost of opening the Town when the settlers introduced a civilization new to the area, almost every major increase occurring in this one hundred and forty year period was stimulated by events beyond the control of the Town. Fire, flood, accident, war, the moving in of poor families, and revision in the laws of the State each was pressing enough to overcome a pervading reluctance to alter the tax rate. Once raised, the rate seldom reverted to the earlier level.

IV. *Borrowing of Irasburg, Orleans County*

Another source of funds is borrowed money. Bulking large at times it has amounted to as much as one-quarter of total income in a given year. Normally, however, it is more a convenient source of cash to fill the interval between sched-

uled disbursements and tax receipts. During the period from 1900 to 1950 when data are relatively complete, changes in " Selectmen's orders outstanding " amounted to one thousand dollars or less in half of the years. At the beginning of the period this approximated 10 per cent of total income and at the end less than 2 per cent.

Interest charges have totalled from less than 1 per cent to 6 per cent of the Town's budget. Prior to 1928 they never exceeded 3 per cent; but in the years from 1928 to 1941 continuing high indebtedness that approximated one-sixth of total income in one year and payment to a local bank of a persistently high (5 per cent) rate of interest, brought these charges to their peak. In 1941 the Selectmen, unable to obtain a reduction in the interest rate from the local bank, shifted their borrowing to investment organizations in Boston at a much more favorable 2 per cent. The local bank met this rate in 1945 and the Town returned its business. Since 1945 interest charges have amounted to less than 1 per cent of the Town's expenses.

Only scattered evidence concerning indebtedness is available for the years prior to 1900. As has always been the case, small loans were obtained from local individuals, usually town officers. Regularly, too, when pressed for funds the Town would delay paying salaries and other charges. Efforts were also made to reduce the face amount of bills owed by the Town by voting in the March meeting something less than the amount due. This was especially notable in settlements for " boarding, nursing, and doctoring " the poor.[21] In spite of the fact that the study by the Census Office covering the fiscal year 1879 showed no debt for Irasburg,[22] indebtedness was clearly a problem as early as 1842. Then appeared the first of a series of annual notes in the warnings of March meetings which read: " To see if the Town will raise money to pay the debts and incidental charges of the Town." [23]

The announced fiscal philosophy of the Town is clearly stated in a special resolution offered in the meeting of March 7, 1922, directing state representatives to economize as much as possible in the present emergency and urging " . . . that economies rather than sentiment shall govern their action on any and all appropriations of state funds . . . . " [24] A rough measure of the *de facto* fiscal policy of the Town may be obtained from a comparison of changes in outstanding loans for each of the fifty years from 1900 to 1950 with changes in unemployment for the country as a whole.[25] If these two series increased and decreased at the same time, i.e., more deficit financing and more unemployment or vice versa, it might

[21] For example, in the meeting of March 9, 1829 it was:

" Voted to allow Doct. Norman Chanbards his bill against Town for nursing time of Justus Bloods family."

" Voted to reconsider last vote."

" Voted to allow Doct. N. Chanbard's Bill at $100.00."

" Irasburg First Book of Town Records," p. 252.

[22] Census Office, Department of Interior, *Report on Valuation, Taxation, and Public Indebtedness in the United States* (Washington: U. S. Government Printing Office, 1884), p. 767.

[23] " Irasburg Book of Records commencing November 1, 1841," p. 6.

[24] *Annual Report of the Officers of the Town of Irasburg*, for the year ending February 1, 1922, p. 4.

[25] National Industrial Conference Board figures of unemployment were used for the period 1900-1945, *Historical Statistics . . . , op. cit.*, p. 65 and Bureau of the Census data for 1946-1950, *Continuation to 1952 . . . , op. cit.*, p. 9.

imply a fiscal policy oriented toward full employment; while if one increased while the other decreased it would imply a policy working against efforts to achieve less unemployment by government spending.

In the case of Irasburg the number of years in which both series increased or decreased together is almost equal to the number of years in which one increased while the other decreased. Special examination of the critical years in which large changes in unemployment took place show slightly more similar movements than dissimilar but still an almost equal division. For example, borrowing was increased by three thousand dollars in 1930 and again by two thousand dollars in 1931, actions in keeping with enlightened fiscal policy; but in 1932 borrowing was reduced by nine thousand five hundred dollars! In short, Irasburg's fiscal policy has neither followed its announced statement of budgetary restraint in times of emergency nor a policy of spending to increase employment. Instead, as is usually the case with local units, exigencies of the moment motivated extemporaneous actions.

V. *Expenditures by Irasburg, Orleans County*

Expenditures by Irasburg over the past century and a half have been concentrated in two areas, roads and schools (Table III).[26] Opening and developing town highways required more funds in the earlier period, education proportionately more in the later. In fact the expenditures on the means of communication between village and farm were so important that both the road commissioner and the selectmen, chief elected officials of the Town, were given the responsibility for parts of the task. For this reason expenditures are normally divided between the highway fund and the general town fund.[27] From almost three-fourths of all town spending in 1820, the importance of these expenditures by highway commissioner and selectmen has declined to about one-third of total payments at the present time.

Aid by the State under numerous guises has played a major role in expanding disbursements on both roads and schools. From 1810 the State required towns to assess minimum amounts for these purposes. Frequently the men at the town meeting would vote to levy no more in taxes for one or the other than the state law required. In many instances, however, a great deal more was raised than the State specified. After allowance is made for the special characteristics of the school-district system, a year by year study of these actions sug-

[26] Prior to 1900, expenditure details, however, could only be located for occasional periods. For this reason, in constructing a year-by-year summary of these data the tax voted to each purpose was adjusted for known expenditures. Usually two modifications were necessary. The catch-all item, incidental or town expenses, was broken into components based on customary practice in the later period, fragmentary comments in town meetings, requirements imposed by the State, and statements of actual expenditures. The second involved imputing a portion of the expenses of schools. Until 1893, education instead of being a responsibility of the town was primarily a function of a varying number of from eight to ten semi-autonomous districts which raised a major share of school costs by levying taxes on property located in the school districts. Fortunately several detailed itemizations of costs, mainly teachers' wages and board plus fuel, appear in the town records. From these and State requirements, total educational costs were imputed for the years before 1893. In this fashion raw tax figures were adjusted in an effort to achieve long-run consistency.

[27] The first is expended by the road commissioner and the second consists of a part of the general fund utilized by the selectmen to improve and maintain the Town's roads and bridges. Because of this dichotomy the published distributions of taxes by purpose substantially understate the amount raised for roads.

gests that there was a greater tendency to vote supplementary amounts above the legal minimum for roads than there was for schools. Even at the state level, highway expenditures generally have exceeded those for schools. Since 1900, for example, state aid for highways has surpassed state aid for schools in twice as many years as aid for schools has topped aid for roads.

State aid took two general forms: reimbursement according to an equalizing formula of taxes paid by the Town to the State; and matching payments from state funds to induce the Town to make certain types of expenditure deemed appropriate by the State. The 61.3 miles of highways in Irasburg are classified into "state highways" (20 per cent), "state aid highways" (19 per cent), and "town highways" (61 per cent). Distinction is also made between summer and winter maintenance. Thus in recent years the State applies detailed formulas to the allocation of aid in each of five categories: town highways, state aid highways, ½ cent gas tax (usable for construction of town and state aid highways), town highways winter, and state aid highways winter.[28] A similar series of provisions encumber aid for education. In 1928 for example, Irasburg received separate payments from the State for advanced instruction, transportation of scholars, cost of a school superintendent, trained teachers above an established minimum, school repairs, and a special bonus.[29]

TABLE III

Per Capita Expenditures by Major Categories in Constant Dollars and in Percentage Terms for Decennial Census Years 1810–1950

Year	Constant dollars (1947–1949)					Percentages				
	Highways	Schools	Welfare	Miscellaneous	Total	Highways	Schools	Welfare	Miscellaneous	Total
1810	$ 1.50	$ 0.50	$ 0.10	$ 0.10	$ 2.20	67%	23%	5%	5%	100%
1820	1.20	0.40	0.10	0.10	1.60	73	27	0	0	100
1830	3.40	1.60	0.20	0.20	5.40	64	30	3	3	100
1840	2.10	1.90	0.10	0.10	4.20	50	46	2	2	100
1850	5.10	3.00	0.30	0.20	8.60	59	34	4	3	100
1860	5.40	5.80	0.70	3.00	14.90	36	29	5	20	100
1870	4.20	4.50	0.50	2.20	11.40	37	40	4	19	100
1880	4.30	4.60	0.70	3.00	12.60	35	36	5	24	100
1890	4.70	6.90	0.90	3.90	16.40	29	42	5	24	100
1900	8.40	6.60	1.60	2.90	19.50	43	34	8	15	100
1910	7.90	13.40	(−0.30)	8.80	29.80	26	45	(−)	29	100
1920	15.40	15.40	(−0.70)	5.70	35.80	43	43	(−)	14	100
1930	15.60	18.10	1.60	8.00	43.30	36	42	4	18	100
1940	23.60	22.40	7.70	12.60	66.30	35	34	12	19	100
1950	29.40	38.20	18.10	8.90	94.60	31	40	19	10	100

(−) Indicates a profit to the Town; i.e., income from the operation of the poor farm was large enough to pay not only the cost of operating the farm but also other welfare payments to indigent individuals not cared for at the farm.

Source: Records listed in Table II and adjustments noted in Table I. In rounding, components adjusted to equal totals.

28 State sources of these funds are: motor vehicle taxes—80 per cent, federal aid—11 per cent, and town assessment—9 per cent. *The Sixteenth Biennial Report on the State Highway Board and the Twenty-Seventh Biennial Report of the Department of Highways*, pp. 44-54.

29 *Annual Report of the Officers of the Town of Irasburg* for the year ending January 31, 1929, p. 29.

The recent upward movement in the welfare account evidences the impact on Irasburg of the social revolution of the 1930's. From a situation in which the poor were a local concern supported on a poor farm that at times even netted a profit, the poor have become primarily a state and federal responsibility. In spite of this, with the selling of the poor farm in 1944, the cost to the Town (over and above large grants in aid to the aged, dependent children, committed children, and the blind) has increased almost four times.

When plotted, the per capita total expenditures in Table III (especially in the latter part of the period) follow a relatively uniform exponential curve. The growth rate is roughly 3 per cent per year.[30] In producing this over-all effect two influences seem to be at work. On the one side the desire to preserve the status quo of the tax rate is at odds with the desire to insure the same services and meet recurring emergencies. Irasburg has a common predilection for maintaining the same tax rate to the exact penny and increasing the rate by one-half cent steps. In general the rates themselves are emphasized and quoted far removed from their context of property valuations and population numbers.[31] Thus there is a strong tendency to be concerned with the rate itself, wholly removed from what it means in dollars, not to mention real, terms. In this situation the influence of local crises and outside pressures is to inch up the rate. After the cause of the initial advance in rate has passed, pressure for an expansion of existing services seems to absorb the increase. Therefore, each new temporary expenditure in its passing provides for the expansion of continuing accounts. In this way crises and proddings have produced a stepwise increase in Irasburg's finances.

VI. *Special Local Governmental Units*

Tailoring their services to smaller groups, complex towns offer a range of tax rates and services. Irasburg and the other simple towns in Orleans County provide to each person approximately the same services and exact from each the same fee per unit of property. Barton, Troy, Derby, and other complex towns in the County superimpose on the township one or more levels of local government, each of which provides some public service to a geographically contiguous group.

Incorporated under such designations as village, school district, fire district, and water district, these units provide a variety of utilities. Although the name itself does not offer an inviolable key to functions performed, it gives some notion of the original purpose of the incorporation. In this connection " village " frequently denotes the lighting of streets. Its only *raison d'être* may be as simple as providing electric street lights to one section of the Town at a cost of \$129.10 for the year 1940, as was the case in West Glover Village; or the purchase of electricity and its distribution to the residents of the section, as in the case of Orleans Village; or even the production of electric power and its sale to residents and others, as in Barton Village. Under this arrangement, since the

[30] With the origin in 1809, the trend line is $Y_t = 1.97\,(1.03)^t$, where Y_t = per capita expenditures in year t.

[31] For example, *The Fifteenth Biennial Report of the State Highway Board . . . , op. cit.*, pp. 63-5, lists separately tax rates and grand list figures for all Vermont towns.

TABLE IV

Per Capita Property-Tax Yields in Constant Dollars
According to Location of Property in Complex Orleans County Towns, 1940
(1947–49)

Location	Tax rate per $1,000 of assesment	Tax yields per capita
Albany Town, average	$ 6.30	$24
Albany Village	n.a.*	n.a.*
Barton Town, average	...	47
Outside villages and districts	5.20	24
Inside Barton Village and Barton Academy and Graded School District	7.70	61
Inside Orleans Village and Orleans Graded School District	7.50	49
Coventry Town, average	6.80	29
Coventry Fire District No. 1	n.a.*	n.a.*
Derby Town, average	...	54
Outside villages	5.80	50
Inside Derby Line Village	7.50	69
Inside Derby Center Village	6.80	39
Glover Town, average	...	39
Outside villages	6.30	44
Inside Glover village	7.40	32
Inside West Glover Village	7.00	30
Greensboro Town, average	...	67
Outside fire district	6.30	66
Inside Greensboro Fire District No. 1	7.00	73
Newport City	5.80	49
Newport Town	5.50	39
Troy Town, average	...	49
Outside school district and village	7.80	52
Inside North Troy Graded School District and North Troy Village	10.30	47

* n.a. indicates no assessment in 1940.

Source: Computed from Vermont Development Commission, *Financial Statistics of State, County and Local Government in Vermont* (Montpelier, Vt.: Vermont Development Commission, 1948), pp. 254–83; population figures from decennial census of 1940. Barton Town figures involve a slight inaccuracy since village and district grand lists are not exactly the same. Adjustment to 1947–49 dollars as noted in Table I.

new unit is simply added to the old, a single taxpayer may vote, receive benefits, and pay taxes to as many as three local governments below the county level.[32]

[32] Newport City is an exception to this rule. The incorporation of a city in Vermont produces a new entity, as in Massachusetts, where the village unit does not exist. In the latter state, the addition of a new political unit often means the subdivision of an old one. Eugene E. Oakes, *Studies in Massachusetts Town Finance* (Cambridge: Harvard University Press, 1937), p. 10.

Barton Town is an example of the operation of this system. Adjacent on the east to Irasburg, it has four small units arranged in two pairs: Barton Village and Barton Academy and Graded School District generally serve the same area; while Orleans Village and Orleans Graded School District likewise overlie. However, they operate different offices, maintain separate accounts, and function as independent organizations. Although population figures are not avail-

able for school districts, little error is introduced by considering school districts as corresponding with villages. If this is done the three situations of persons living in Barton Town shown in Table IV are produced: those living outside the villages and school districts, those living in Barton Village and Barton Academy and Graded School District, and those living in Orleans Village and Orleans Graded School District.

On the average the tax rate per $1000 of property valuation in 1940 was more than 40 per cent higher in the villages and districts of Barton Town than outside. Since per capita assessed values are larger in the villages, per capita tax yields are about twice as high as those usually found in the more sparsely populated areas outside of the villages.

It may be recalled from Table I that Irasburg's per capita assessments averaged $48 in 1940 or very close to Barton's $47. This suggests that the over-all financial development of Irasburg may even be typical of the over-all development of complex communities. It furnishes also some additional evidence that the influence of practices in neighboring communities on tax rates is greater than the influence of the structure of the government.[33] Some such proclivity is notable elsewhere. Derby Town with an average rate of $54 per person not only abuts the towns of Holland, Morgan, Charleston, and Newport City where assessments are $60, $61, $55, and $49, respectively, but also adjoins Brownington where the rate is $37. Part of the divergency arises from variations in population densities and natural resources, but part also from differences in the levels of local public affairs. Here, as elsewhere, the apparent tendency is to keep up with the leaders rather than to follow the stragglers.

Mainly the complex town is an example of a reversal of standardization. Noted throughout these pages has been a movement toward uniformity. Each of the forces—the Veblenesque effect of keeping up with neighboring communities, state aid for highways and schools, and federal grants for the aged—has tended to provide every person with the same public services. The complex town attempts to furnish special groups with utilities not available or desired by everyone. Even though the average expenditure throughout the complex town differs little from the average of simple towns, the residents of various sections within a complex town have available a substantial range of alternative services.

VII. *Conclusion*

Irasburg and Orleans County are samples, representative of the special case of decadent farming areas. As such they depict a polar extreme, a limiting example of the development of local finance in the United States. Even in this setting, rapid growth is evident. In per capita terms stated in dollars of fixed purchasing power revenue was found to grow at a rate of about 3 per cent each year, or almost fifty fold during the full period from 1810 to 1950. If further adjustments are made in the data to allow for changes in the money available for spending, the rate of growth is 1.5 per cent faster per year than the growth of real per capita income in the United States.[34] Recent findings in the field of national income imply that the direc-

[33] J. R. and U. K. Hicks, *op. cit.*, p. 19.

[34] With origin in 1809, the equation is $Y_t = 1.9\,(1.015)^t$, where Y_t = real per capita expenditure in year t adjusted for growth of income.

tion of the error inherent in these figures leads to an understatement, rather than to an overstatement of the rate of growth. Thus in spite of the fragmentary data and tenuous adjustments, local expenditures in dollar terms now take several times as large a share of total income as they did one hundred and forty years ago.

With the help of outside proddings, the town became increasingly concerned with social amenities, especially of the long-ranged sort. Welfare, particularly of the aged, engrossed an increasing share of total revenue. But more important and more persistent, education both in relative and in actual terms became the most important expenditure category, engrossing a full two-fifths of total revenue. Also, complex towns, in an effort to satisfy demands for innovation by some individuals without introducing a change for all, now provide more public services to some residents than they do to others.

Thus, the long-term forces of local conservatism have vied with the pressures for change engendered internally by fires, floods, and local crises and those applied from without by the state, the federal government, and interested individuals.[35] Responding to these stimuli, rapid growth has occurred in spending at the local level. Instead of the physical law concerning a body at rest tending to remain at rest, the evidence presented here implies that although a small group's financial pattern tends to persist unaltered, the compulsion of internal crises and external force produce continually increasing expenditures.

[35] For example, the library was given to the Town of Irasburg by Orrin A. Leach of Wahpeton, North Dakota, who spent his boyhood in Irasburg, *Annual Report of the Officers of the Town of Irasburg,* for the year ending February 1, 1926, p. 4.

MEASURING STATE TAX BURDENS

HENRY J. FRANK *

Introduction

ONE of the questions posed by business men, politicians, and students of public finance is: "Are taxes in this state higher than in that one?" In order to answer the question and related queries, two measures of variation in interstate tax burdens have been frequently used: taxes per capita and taxes as a per cent of income. Total tax collections in one state may be compared meaningfully to total tax collections in another state only if the two states are reasonably alike in population or income. Per capita taxes gauge variation in tax burden by reducing all states to a common denominator of population. Taxes as a per cent of income is a standard which uses personal income in each state as a common basis.

Both measures have their advantages and both have their shortcomings. Often the two measures for any one state are cited in conjunction with one another. A more useful device for comparing interstate tax burdens is an index of tax sacrifice suggested in this article, which is a synthesis of the two above-mentioned measures.

Measures of interstate variations in tax burden rely on three basic figures, all of them estimates: population, personal income, and tax collections. In putting together estimates of population, income, and tax collections, a composite value is derived which contains all the errors of the original figures. The results should not be accorded the sanctity of an accountant's certification, but must be viewed as attempts to compile information from the best estimates available. The chief virtue of each set of figures is its internal consistency. The governmental bureau involved, presumably applied the same statistical techniques to all the states, and while the estimating error indicates that the figures must be used and interpreted with caution, it does not appreciably vitiate the analysis.

Per Capita Taxes

State and local tax collections per capita in each of the 48 states are available in recent years for 1953 and 1957.[1]

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[1] All data in this article were derived from the following publications of the U. S. Government Printing Office:

1953 Taxes: U. S. Bureau of the Census. *State and Local Government Revenue in 1953*, State and Local Government Special Studies, No. 37 (Washington: Oct. 27, 1954).

1957 Taxes: U. S. Bureau of the Census. *State and Local Government Finances in 1957*, 1957 Census of Governments Advance Release No. 8 (Washington: Feb. 1959).

1953 Population: U. S. Bureau of the Census. *Current Population Reports, Population Estimates*, Series P-25, No. 145 (Washington: Oct. 19, 1956), p. 6.

1957 Population: U. S. Bureau of the Census. *Current Population Reports, Population Estimates*, Series P-25, No. 168 (Washington: Dec. 9, 1957), p. 3.

1953 Personal Income: U. S. Department of Commerce, Office of Business Economics. *Personal Income by States Since 1929* (Washington: 1956), p. 141.

1957 Personal Income: U. S. Department of Commerce, Office of Business Economics. *Survey of Current Business*, Vol. 38, No. 8 (Washington: August 1958), p. 13.

In 1953 they ranged from a high of $184.55 for New York to a low of $74.23 for Alabama, and averaged $132.11. In 1957 they ranged from a high of $237.14 for California to a low of $101.08 for Arkansas, and averaged $169.08. There were comparable increases all along the line. In both 1953 and 1957 the higher per capita tax states were New York, Nevada, and California.[2] Lowest per capita taxes in 1953 and 1957 were paid in Arkansas and Alabama, with Kentucky a member of this group in 1953 and South Carolina in 1957.

Per capita taxes are basically a weak measure of tax burden. They are a step forward in the measurement of tax burdens compared to the use of total tax collections, since they are a means of adjusting for differences in size of population in the various states. However, the population estimate in the state is limited to the number of residents at a given time, and each resident is given a value of one regardless of his age, condition, or position in the economy.

Taxes as a Per Cent of Income

State and local taxes as a per cent of personal income ranged in 1953 from a high of 11.148 per cent for North Dakota to a low of 4.054 per cent for Delaware, and averaged 7.396 per cent. In 1957, the same states were at the top and the bottom, with a high of 11.633 per cent, and a low of 4.896 per cent, and the average take was 8.351 per cent.[3] In 1953, the three highest states were North Dakota, South Dakota, and Louisiana. In 1957 Mississippi substituted for Louisiana. In 1953 Ohio, Connecticut, Pennsylvania, and Delaware imposed the lightest tax burdens on income. By 1957, Missouri and New Jersey had displaced Connecticut and Pennsylvania, but Delaware was far below the others in both years.

The greatest increase between 1953 and 1957 in state and local taxes as a per cent of personal income took place in Montana and Virginia where they rose about one-third. Oregon's and Pennsylvania's increase was almost as spectacular—over one-fourth—with Nevada, the last state to adopt a general retail sales tax (1955), not far behind.

The states that improved their positions the most by this measure were Florida, New Hampshire, and Nebraska. In Florida and New Hampshire, taxes related to personal income increased less than 2 per cent between 1953 and 1957. Nebraska was unique: alone of all the 48 states it permitted increases in personal income to outpace increases in taxes. It was one of the three states that in 1957 had no sales or income taxes. Florida's broad-based tax, the 3 per cent retail sales tax, remained basically unchanged during this period, but the 50-per cent increase in personal income produced a sharp rise in revenues. New Hampshire, like Nebraska, is noted for its absence of broad-based taxes. The income tax in New Hampshire applies only to investment income, and in many respects resembles the intangibles taxes in Ohio, Indiana, and Michigan, more than the personal income taxes of the New York, Wisconsin, or California variety.

Taxes and Per Capita Incomes

Attempts to measure tax burden among the various states are basically

[2] Per capita amounts are derived by dividing total tax collections by the resident population, on the assumption that the resident population pays all the taxes. In the states mentioned, it is probable that non-residents pay a greater share of the taxes than in other states.

[3] The sources are indicated in footnote 1 above.

TABLE I

CORRELATION OF PER CAPITA INCOME AND STATE AND LOCAL TAXES
AS A PER CENT OF PERSONAL INCOME
48 STATES, 1953 AND 1957

Per capita personal income	State and local taxes as a per cent of personal income							
	Total states	4.000–5.999	6.000–6.999	7.000–7.999	8.000–8.999	9.000–9.999	10.000–10.999	11.000–11.999
	1953							
$2,750–$2,999	..	..	..	..	..	..	..	..
2,500– 2,749	..	..	..	..	..	..	..	..
2,250– 2,499	3	2	..	1	..	..	..	..
2,000– 2,249	6	1	3	..	2	..	..	..
1,750– 1,999	10	1	3	2	4	..	..	..
1,500– 1,749	11	1	1	1	6	2	..	..
1,250– 1,499	9	..	2	..	3	2	2	..
1,000– 1,249	7	..	2	2	2	..	..	1
750– 999	2	..	..	1	..	1	..	..
Totals	48	5	11	7	17	5	2	1
	1957							
$2,750–$2,999	1	..	..	1	..	..	..	..
2,500– 2,749	4	1	1	..	..	2	..	..
2,250– 2,499	4	..	1	1	1	1	..	..
2,000– 2,249	6	..	..	3	2	1	..	..
1,750– 1,999	14	..	1	3	2	7	1	..
1,500– 1,749	10	..	..	2	..	5	3	..
1,250– 1,499	6	..	..	2	3	..	..	1
1,000– 1,249	2	..	..	..	2	..	..	..
750– 999	1	..	..	..	..	..	..	1
Totals	48	1	3	12	10	16	4	2

Sources: See footnote 1.

attempts to measure the importance of the public sector vis-a-vis the private sector in the economy. Taxes do not come out of income and disappear from the economy to remain evermore in an Independent Treasury. They flow through the governmental units back into the income stream as salaries to personnel and purchases of goods and services. When taxes are measured against income, part of that income is created by the very taxes being discussed. In comparing state and local taxes to income, what is not known is the amount or number of tax dollars that go back to the geographic source.

State and local taxes as a per cent of personal income measures the amount of income that individuals must give up to sustain certain governmental units. However, as Table I indicates, in the higher income states, individuals are asked to give up a smaller proportion of their income for taxes. In both years shown, it is apparent that in states where per capita incomes are low state and local taxes are high. A rather consistent pattern appears. A simple linear correlation coefficient was computed between state and local taxes as a per cent of personal income and per capita personal income for each of the years. In 1953,

$r = -.47$, and in 1957 $r = -.43$. Both measures are highly significant for a sample of 48 variables. It may be concluded, therefore, that higher per capita personal incomes among states are associated with lower percentages of state and local taxes to total incomes. In comparing the tax burden among states, if one state's taxes as a per cent of income are greater than another's, it is also likely that its per capita income is lower.

Degree of Sacrifice of Income for Taxes

While differences in tax burdens among the states are usually measured by per capita amounts or by percentages of income, these measures are not completely satisfactory. Per capita taxes indicate the amount of contribution assessed to the average member of society without reference to his ability to pay. Taxes as a per cent of income do not indicate the efforts of a society to produce a given quantum of income. For instance, in a society where ten persons can produce the same amount as in another where fifteen persons are necessary, the payment of a tithe of total production is less of a burden on its members than on the members of the poorer society. In fact, this is the principle (equality of sacrifice) on which the progressive individual net income tax is based. A welding together of the two usual measures of tax burden gives a measure of the degree of sacrifice involved in the payment of taxes. In California, in 1957, state and local taxes were equal to 9.398 per cent of the personal income, while in Colorado they were equal to 9.399 per cent. In both states the same part of personal income was devoted to state and local governmental purposes. However in California the per capita personal income was $2,523 as opposed to only $1,996 in Colorado, or fully one-fourth greater. The Californian will make less of a sacrifice to give up 9.4 per cent of his income for taxes, than will the Colorado resident to give up his 9.4 per cent.

In order to measure the degree of sacrifice involved in each state, on the average, for the payment of state and local taxes, taxes as a per cent of personal income were divided by per capita personal income. The underlying assumption is that in two states with identical taxes per dollar of income, the resident of the state where per capita personal income is greater, will have to make less of a sacrifice, in order to pay. This computation yields an index of tax sacrifice in 1957 of 3.725 for California and 4.709 for Colorado, indicating clearly the greater burden of taxation in Colorado. Whereas, in 1957, California ranked first and Colorado ranked tenth in per capita taxes, and Colorado ranked 16th and California 17th in the per cent of income taken by taxes, insofar as degree of tax sacrifice is concerned Colorado ranks 27th and California 38th. The results for each state are shown in Table II.

It is recognized that such a measure gives reasonable results only within limits of the empirical data. Theoretical assumptions of taxes greater than income, or of per capita personal income in one state ten times that of another, yield absurd results. Objections to this measure on the ground that it seeks to quantify interpersonal comparisons are also recognized. However, even if the cardinal results are discounted, the ordinal results are still useful. This measure involves a squaring of income, which may be defended as a means to give a greater weight to income, than to taxes, which flow back into the income stream.

TABLE II

MEASURE OF DEGREE OF SACRIFICE OF INCOME FOR TAXES IN EACH OF THE 48 STATES 1953 AND 1957

State	Measure of tax sacrifice					
	1953			1957		
	Per capita income	Measure of burden[1] Index	Measure of burden[1] Rank	Per capita income	Measure of burden[1] Index	Measure of burden[1] Rank
Alabama	$1,081	6.353	9	$1,324	5.779	13
Arizona	1,610	5.199	23	1,750	5.263	21
Arkansas	988	7.991	3	1,151	7.630	3
California	2,196	3.719	36	2,523	3.725	38
Colorado	1,735	5.122	25	1,996	4.709	27
Connecticut	2,418	2.419	47	2,821	2.593	47
Delaware	2,482	1.633	48	2,740	1.787	48
Florida	1,556	5.623	17	1,836	4.859	25
Georgia	1,246	6.074	14	1,431	6.040	10
Idaho	1,487	6.167	10	1,630	5.880	11
Illinois	2,185	2.836	45	2,447	3.017	44
Indiana	1,920	3.522	38	2,010	3.487	41
Iowa	1,546	6.084	13	1,806	5.374	20
Kansas	1,641	5.413	20	1,787	5.426	18
Kentucky	1,224	5.200	22	1,372	5.708	14
Louisiana	1,296	7.851	4	1,566	6.642	6
Maine	1,455	6.147	11	1,663	5.566	16
Maryland	1,986	3.087	43	2,156	3.399	43
Massachusetts	1,963	4.351	30	2,335	3.825	36
Michigan	2,120	3.259	40	2,141	3.902	34
Minnesota	1,646	5.553	18	1,850	5.245	23
Mississippi	874	10.646	1	958	11.730	1
Missouri	1,721	3.479	39	1,940	3.453	42
Montana	1,786	4.217	32	1,896	5.262	22
Nebraska	1,578	4.957	27	1,818	4.229	32
Nevada	2,357	3.244	41	2,423	3.831	35
New Hampshire	1,576	5.141	24	1,862	4.397	30
New Jersey	2,224	2.872	44	2,504	2.774	46
New Mexico	1,394	6.065	15	1,686	5.431	17
New York	2,150	3.991	35	2,578	3.507	40
North Carolina	1,165	6.994	7	1,317	6.451	7
North Dakota	1,228	9.078	2	1,435	8.107	2
Ohio	2,032	2.771	46	2,255	3.010	45
Oklahoma	1,459	6.119	12	1,619	5.812	12
Oregon	1,811	4.534	29	1,914	5.399	19
Pennsylvania	1,892	3.161	42	2,112	3.598	39
Rhode Island	1,893	3.621	37	1,990	3.813	37
South Carolina	1,132	7.495	6	1,180	7.456	4
South Dakota	1,331	7.803	5	1,531	6.941	5
Tennessee	1,219	5.818	16	1,383	6.137	9
Texas	1,550	4.261	31	1,791	4.289	31
Utah	1,528	5.419	19	1,694	5.595	15
Vermont	1,441	6.555	8	1,665	6.297	8
Virginia	1,481	4.078	33	1,660	4.816	26
Washington	1,971	4.016	34	2,128	4.159	33
West Virginia	1,278	5.325	21	1,554	4.610	29
Wisconsin	1,770	4.969	26	1,920	4.995	24
Wyoming	1,861	4.678	28	2,038	4.632	28
United States Total	$1,788	4.136		$2,025	4.124	

[1] State and local taxes as a per cent of personal income divided by per capita personal income.
Sources: See footnote 1.

The measure of the degree of sacrifice of income for taxes, like those computed on a per capita or a percentage of income basis, is a measure of averages. No attempt is made to discover who makes the sacrifice, nor how equitably the sacrifice is borne by residents of the same state. Such a measure applies to all taxes whether levied on incomes, sales, properties, or privileges, whether paid by individuals or businesses, and without regard to the ultimate incidence of any of the taxes.

The application of this measure yields consistent and expected results. Where are taxes highest? In Mississippi, and they are substantially higher than in North Dakota, where in turn they are higher than Arkansas. This relationship existed in 1953 and 1957. In fact the eight highest ranking states, Mississippi, North Dakota, Arkansas, South Carolina, South Dakota, Louisiana, North Carolina, and Vermont, are identical for 1953 and 1957, except that South Carolina and Louisiana interchanged fourth and sixth place between the two years. A similar situation appears at the lower end of the scale. Tax sacrifice is lowest in Delaware, and next lowest in Connecticut, in 1953 and 1957. The six lowest states, Delaware, Connecticut, New Jersey, Ohio, Illinois, and Maryland are also the same for both years shown. The above order applies for 1957; in 1953, 46th, 45th, and 44th ranking states were Ohio, Illinois, and New Jersey. It may be noted that four of the six low tax sacrifice states are in the Northeast and the other two are in the Midwest. Of the high tax sacrifice states, five of the eight are in the Deep South. Vermont, and the two Dakotas are the other members of this group.

Thirteen of the 48 states held the same rank in the index of tax sacrifice in 1953 and 1957. Another 20 moved a few places in either direction. Only 16 states changed their rank by more than four places. Because of the nature of this index, changes in the rank of the states between the two years do not necessarily correspond to magnitudes of change in the index itself.

The greatest increase in tax sacrifice between 1953 and 1957, according to the figures available, took place in Montana, the same state that showed the greatest increase in taxes as a per cent of income. The next greatest increases in this measure were found in Michigan, Oregon, Virginia, Nevada, and Pennsylvania, in that order. Except for Michigan, all these states were the leaders in increases in state and local taxes as a per cent of income. Michigan comes in high because of the squaring of income involved in the tax sacrifice measure. This measure also serves to indicate that Michigan's current (April 1959) financial difficulties may be ascribed primarily to the failure of per capita incomes in the state to rise rather than to any failure to provide revenue-raising imposts. In 1953 per capita income in Michigan was $2,120 against a national average of $1,788, while in 1957 it was $2,141 against a national average of $2,025.

The greatest declines in tax sacrifice between 1953 and 1957 occurred in Louisiana and Nebraska. The absolute value of the index is so great in Louisiana that the percentage decline only served to reduce its rank from 4th place in 1953 to 6th place in 1957. Nebraska was the only state where state and local taxes as a percentage of personal income declined absolutely between 1953 and 1957. The other states registering the greatest declines in tax sacrifice between the two years, in order, were: New

Hampshire, Florida, West Virginia, New York, Massachusetts, and Iowa.

Uses of the Measure of Tax Sacrifice

Although this measure has some advantages in measuring changes between two points in time, its greatest applicability is among comparable units during the same moment of time. In measuring change between two periods, the results will not be too different from that obtained by measuring changes in taxes as a per cent of income. In the present decade wherein price inflation and increases in state and local tax revenues seem to occur simultaneously, the index of tax sacrifice will remain relatively constant. Average per capita income in the 48 states increased from $1,788 in 1953 to $2,025 in 1957, state and local taxes as a per cent of personal income increased from 7.396 per cent in 1953 to 8.351 per cent in 1957, but the average index of tax sacrifice stood at 4.136 in 1953 and at 4.124 in 1957.

In comparing tax burdens among states in any one year, the measure of degree of tax sacrifice suggested here will effectively point up the places where they are high, where they are low, and permit comparison of any two states. Comparing tax burdens on a per capita basis takes no account of the varying incomes among the states. Comparing tax burdens on a percentage of income basis takes no account of the greater sacrifice required from the members of some economies to give up a part of their income for taxes. The index of tax sacrifice, suggested in this article, remedies these defects in the usual comparative measures.

BOOK NOTES

Michigan Tax Study: Staff Papers. Lansing Michigan, 1958. Pp. 573. $5.00.

These staff papers were prepared under the direction of Harvey E. Brazer, Director of Research, for the Legislative and Citizens' Advisory Committees to the Michigan Tax Study. There are 23 separate studies comprehensively covering the tax problems of Michigan. The first gives historical background (Brazer and others), the next is a study of the locational effects of taxes (Stolper); the third considers their impact on farmers (Barlowe); the fourth is a quantitative study of their distributional effects (Musgrave and Daicoff). Then follow 16 chapters on particular taxes. The last three chapters are on local government and intergovernmental financial relationships.

Federal Budget and Fiscal Policy, 1789-1958. By Lewis H. Kimmel. The Brookings Institution, Washington, D. C., 1958. Pp. 337. $5.00.

This monograph is a carefully documented examination into the evolution of budgetary ideas and philosophies, both academic and politic, in the United States since its founding. Particular emphasis (two-thirds of the book) is given over to the period of the thirties and subsequently when attitudes changed drastically toward fiscal policy. The author finds that "the unfolding of events" has a major influence on fiscal policies, and accounts for the early attitude toward budgetary balance as well as the present flexible view that regards the budget surplus or deficit as an instrument of policy, not an end. An appendix summarizes the federal budgetary record.

The Theory of Public Finance. By Richard A. Musgrave. McGraw-Hill Book Company, Inc., New York, 1959. Pp. 628. $12.50.

This comprehensive treatise will be required study for all serious students of the economics of public finance. It is built around a three-fold division of budgetary problems: (1) the allocation of resources between the private and public sector; (2) the distribution of income; and (3) the stabilization of economic activity. The first two constitute the classical problems of public finance, while the last, compensatory finance, is the modern addition to fiscal theory. Each occupies about a third of the volume.

This is a remarkable book in many ways: a major attempt at integrating public-finance theory; impressively broad and penetrating in its coverage of topics; and thoroughly documented — the footnotes alone contain a substantial bibliography.

Fiscal Policy and Politics. By Paul J. Strayer. Harper and Brothers, New York, 1958. Pp. 305. $4.00.

The purpose of this volume is to correct the underemphasis in fiscal policy on politics. It briefly reviews fiscal history since the depression of the thirties and then turns its at-

tention to stabilization theory in general, expenditure and tax policy in particular, and lastly state and local problems. The author believes that not enough is known about the economic aspects of stabilization policy to apply it successfully, and, even if enough were known, political forces would inhibit its effective use.

Taxation of Agricultural Land in Underdeveloped Economies. By Haskell P. Wald. Harvard University Press, Cambridge, Mass., 1959. Pp. 231. $4.50.

The Harvard Law School International Program in Taxation adds here another volume to its growing list of publications, one that grew out of the 1954 Conference on Agricultural Taxation and Economic Development. It first surveys land taxation throughout the world; next considers these taxes in relationship to policy goals—equity, agricultural development and resource allocation, and administration; finally, makes proposals for the more effective use of such taxes to fairly mobilize savings for capital formation in a developing economy.

The Income-Tax Burden on Stockholders. By Daniel M. Holland. Princeton University Press, Princeton, 1958. Pp. 241. $5.00.

What quantitative appraisal can be made of the corporate tax as a burden on stockholders? Results will depend largely on assumptions made regarding corporate behavior, and the author performs the service of showing the quantitative consequences of different behavioral assumptions. Subject to qualifications imposed by data and analysis, which the author repeatedly emphasizes, he finds that:

1. " Overtaxation " of stockholders is not always present and varies inversely with their income. The extent that the tax is shifted, " overtaxation " is further reduced.

2. In 1957 the corporate income tax could have been replaced by a hike of 3 percentage points in the personal income tax rate, provided stockholders were taxed on their pro-rata share of corporate earnings.

3. The degree of progressivity achieved by the corporate tax is uneven and indiscriminate.

4. The 1954 dividend credit was a clumsy and capricious way of reducing " overtaxation " or " undertaxation " of stockholders.

Classics in the Theory of Public Finance. Edited by Richard A. Musgrave and Alan T. Peacock. The Macmillan Company, New York, 1958. Pp. 244. $6.00.

These 16 classic essays in public finance, most of which are made available in English for the first time, have been taken from the debate between Continental writers on " the optimum distribution of resources between the government and the private sector, and with the ideal means of taxing individuals so that resources could be put at the disposal of the state." The selections cover all important schools of thought of the period covered (about a generation each side of the turn of this century), such as Wagner, Wicksell, Edgeworth, Leroy-Beaulieu, Sax, Wieser, and Lindahl. The editors provide a brief introductory review of the evolution of the discussion. The volume is sponsored by the International Economic Association.

Readings in the Economics of Taxation. Richard A. Musgrave and Carl S. Shoup, Selection Committee for the American Economic Association. Richard D. Irwin, Inc., Homewood, Ill., 1959. Pp. 581. $6.50.

This set of readings has been restricted to theoretical works that " seem useful in current research and teaching in public finance,"

that are not readily available to students, and that were written before 1952 (to avoid overemphasis on recent material). The 32 selections are grouped under two broad headings: (1) equity and welfare, and (2) incidence and incentive effects. A classified bibliography of taxation completes the volume.

The Economic Theory of Fiscal Policy. By Bent Hansen (translated by P. E. Burke). George Allen and Unwin, Ltd., London, 1958. Pp. 450. $8.00 or 45s.

This volume is a translation of an earlier study (1955) by the author made for the Swedish Government. It is primarily focused on the economic theory of maintaining stable money at full employment, and in this sense is considerably narrower than Musgrave's treatise. Nevertheless, it is a broad approach to this particular subject. In the first section it deals with the general theory of fiscal policy along the lines, although independently, of Tinbergen's work. The second and third section treat, respectively, the micro- and macro-economics of fiscal policy. It is somewhat more advanced mathematically than is Musgrave's work.

Capital Taxation in a Developing Economy (India). By I. S. Gulati. Orient Longmans, Calcutta, 1957. Pp. 209. Rs 12.50.

There are few general studies of capital taxation. This one is divided into three parts: the theory of capital taxation; its relationship to Indian economic development; and a critique of the Indian estate duty.

Public Principles of Public Debt: A Defense and Restatement. By James Buchanan. Richard D. Irwin, Inc., Homewood, Ill., 1958. Pp. 223. $5.00.

The new Keynesian orthodoxy regarding the public debt is reexamined in this monograph. The author finds that, in contrast to current views, " the analogy between the public economy and the private economy is applicable to most of the problems of the public debt and that public debt creation does involve a shifting of the real burden to future generations of taxpayers." Essentially, therefore, this book is an attempt to reestablish the " classical " theories of the public debt.

NTA NOTES

From the President

The activities of our Association since I last outlined them in the March issue of the Tax Journal have been somewhat limited.

The Interstate Allocation Committee, under the chairmanship of Fred L. Cox, State Department of Revenue, Atlanta, Georgia, has been extremely busy by reason of the United States Supreme Court decisions in the Northwest Portland Cement and Stockham Valve cases. Their principal objective at the present time is the redrafting and adoption of a satisfactory formula for the uniform division of income for tax purposes. The efforts of this Committee will be of great value to the National Council of Commissioners on Uniform State Laws. The Committee is endeavoring to redraft a formula that will eliminate the principal objections of business groups and at the same time meet the major requirements of tax administrators. I am sure you will agree that this is no small task. Any views the members of NTA may have on this subject should be sent to Mr. Cox in order that the Committee might benefit therefrom.

At a meeting of the NTA Executive Committee in Chicago last February, a new study committee was authorized to be known as " Committee on Costs of Taxpayer Compliance and Administration." All of the members of the Committee have been appointed and the Committee is now functioning under the able leadership of Mr. Aaron K. Neeld, former State Treasurer of New Jersey, as Chairman. Chairman Neeld's address is 9 Cornwall Avenue, Trenton 8, New Jersey.

Members of the Committee, in addition to Chairman Neeld, and their affiliations are as follow:

Carter W. Atkins, Executive Director, Connecticut Public Expenditure Council

James S. Currie, Commissioner of Revenue of North Carolina

Chester M. Edelmann, Treasurer, H. L. Green Co., New York

Arch Ely, Wisconsin Citizen's Public Expenditure Survey

Harry L. Hulman, Tax Department, Sears, Roebuck & Co., Chicago

Walter L. Kidd, Tax Accountant, American Telephone & Telegraph Co., New York

Arthur D. Lynn, Jr., Associate Professor of Economics, The Ohio State University

James W. Martin, Director, Bureau of Business Research, University of Kentucky

Chester B. Pond, Director, Tax Research & Statistics, Dept. of Taxation and Finance of New York

Joseph M. Robertson, Tax Commissioner of Minnesota

On May 28, I received from Alvin Burger, Chairman of the Program Committee for the Houston Conference, a tentative outline of subjects scheduled for the program and the names of some of the participants. The program is excellent and Al and his committee are doing a fine job. Details of the program will be furnished in my notes in the September Journal.

The Local Arrangements Committee, of which Phil Robira is Chairman, is well along with plans for the Houston meeting. You should definitely mark your calendar for this conference which is being held at the Rice Hotel October 25-29 this year.

Mr. Walter Walsh, Chairman of the Membership Committee, needs your assistance and again I urge each of you to PLEASE

USE THE CARD ENCLOSED IN THE BACK OF THE JOURNAL

to obtain a new member or to recommend a personal acquaintance for membership. I trust Walter will receive your assistance and cooperation in this undertaking.

The next Executive Meeting of NTA is to be held at the Statler Hilton Hotel in Buffalo, N. Y. on July 9. The annual meeting of the National Association of Tax Administrators is being held at the same place from July 8-11, inclusive. Quite a number of the Executive Committee attend the annual meeting of NATA and by holding the NTA Executive Committee meeting at the same time, they will be able to attend both events.

Activities of NTA other than those herein outlined are furnished by our Executive Director, Walter Kress, in the following pages.

Stanley J. Bowers
President

From the Executive Director

President Bowers' notes should be carefully read by all NTA members as they tell about important activities of the Association.

The Houston Conference

Because there have been so many inquiries regarding the coming conference in Houston, Texas, I wish to take this opportunity to elaborate on the preparations and prospects of what promises to be an outstanding gathering in a most interesting part of the United States—

Time and Place

OCTOBER 25-29, 1959 — RICE HOTEL, HOUSTON, TEXAS

OPENING RECEPTION — SUNDAY AFTERNOON, OCTOBER 25

* * * * *

In late April I visited Texas, and at Houston conferences were held with Phil Robira and Al Burger, the able Chairmen of the Local Arrangements Committee and of the Program Committee respectively. Max Peck, the Resident Manager of the Rice Hotel, and Frank Bobo, the Convention Manager, joined in some of these conferences. There were two meetings of the Local Arrangements Committee. There was a trip to a fabulous development, some miles from Houston, where a Rodeo and Barbecue (typically Texan) will entertain and thrill all who attend on Tuesday afternoon and evening, October 27th.

A finer setup for the business of a tax conference has never been seen. Improvements which will be finished at the Rice Hotel prior to the conference will assure ready access from outside or inside the hotel to the mezzanine floor where all the major activities will take place. The luncheon and banquet facilities, as well as those for smaller functions, are more than adequate. The rooms for concurrent sessions are on the same floor. In fact, they are adjacent to each other, so one may move from one session to the other with minimum ease in time and space.

EVERY ROOM IS AIR CONDITIONED

FOOD AND TRANSPORTATION COSTS ARE REASONABLE

At Austin, Program Chairman Burger and I visited Governor Price Daniel and not only invited him to welcome the conference guests to Texas but also asked him to write the other governors of the United States and its possessions, the District of Columbia and Canadian Provinces to send delegates to the Conference. The Governor graciously accepted both requests.

Anyone who misses this conference will forego a fine technical program as well as the acme in entertainment and unusual features. There are other plans which cannot be divulged at this time.

IN AUGUST, LETTERS ENCLOSING HOTEL RESERVATION CARDS AND PRELIMINARY PROGRAMS WILL BE MAILED TO ALL MEMBERS

The Secretary's letter, giving the nominees for NTA offices and honorary membership, will accompany this letter. Later, the appointed delegates will also receive letters and hotel reservation cards.

Study Committee Appointments—Meeting of New Committee

President Bowers has listed the membership of the newly created Study Committee on Costs of Taxpayer Compliance and Administration.

Chairman Neeld is planning for the first meeting of this committee in Buffalo, July 8, during the NATA Conference at the Hotel Statler Hilton in that city (the day prior to the meeting of the NTA Executive Committee which is mentioned in President Bowers' notes).

Jerome R. Hellerstein, a valued member and a participant in the Philadelphia Conference, has accepted appointment on the Committee on Interstate Allocation of Business Income.

Membership

Again President Bowers urges you to

PLEASE USE THE ATTACHED CARD.

Some of these are coming in—please send more. If same is used as an *Application,* it should be mailed to the undersigned. If it is used as a *Recommendation,* it should be mailed to Walter W. Walsh, Chairman, Membership Committee, c/o Chapman, Walsh & O'Connell, 122 E. 42nd Street, New York 15.

WALTER J. KRESS
Executive Director

NATIONAL TAX ASSOCIATION

Organized 1907—Incorporated 1930

OBJECT. The National Tax Association is a non-political, non-sectarian, and non-profit-making educational organization. Its object, as stated in its certificate of incorporation, is to educate and benefit its members and others by promoting the scientific study of taxation and public finance; by encouraging research; by collecting, preserving, and diffusing scientific information; by organizing conferences; by appointing committees for the investigation of special problems; by formulating and announcing, through the deliberately expressed opinion of its conferences, the best informed thought and ripest administrative experience available; and by promoting better understanding of the common interests of national, state, and local governments in the United States and elsewhere, in matters of taxation and public finance and interstate and international comity in taxation.

MEMBERSHIPS. The Association welcomes to its membership, for mutual discussion and deliberation, all who may be interested in taxation and public finance generally. Annual dues are: memberships for students in recognized institutions of higher learning, $10; memberships for government agencies, schools, and persons receiving more than one-half of their income from employment by such agencies or schools, $10; memberships for other individuals and unincorporated entities, $25; corporate memberships, $100; persons wishing to contribute more liberally to the support of the Association, $100 to $1000.

PUBLICATIONS. The NATIONAL TAX JOURNAL is published quarterly in March, June, September, and December. PROCEEDINGS of the annual conferences on taxation which are sponsored by the Association are published soon after the meetings. The JOURNAL and the PROCEEDINGS are sent to members without charge. To non-members the price of the JOURNAL is $5.00 per year, single numbers, $1.50. The prices of the PROCEEDINGS vary; that of the 1958 volume is $12.00.

Applications for membership, orders for publications, and general inquiries should be addressed to Walter J. Kress, Executive Director, National Tax Association, 905 Payne-Shoemaker Building, Harrisburg, Pennsylvania.
